

# Mercury General Corporation NYSE:MCY

## FQ1 2019 Earnings Call Transcripts

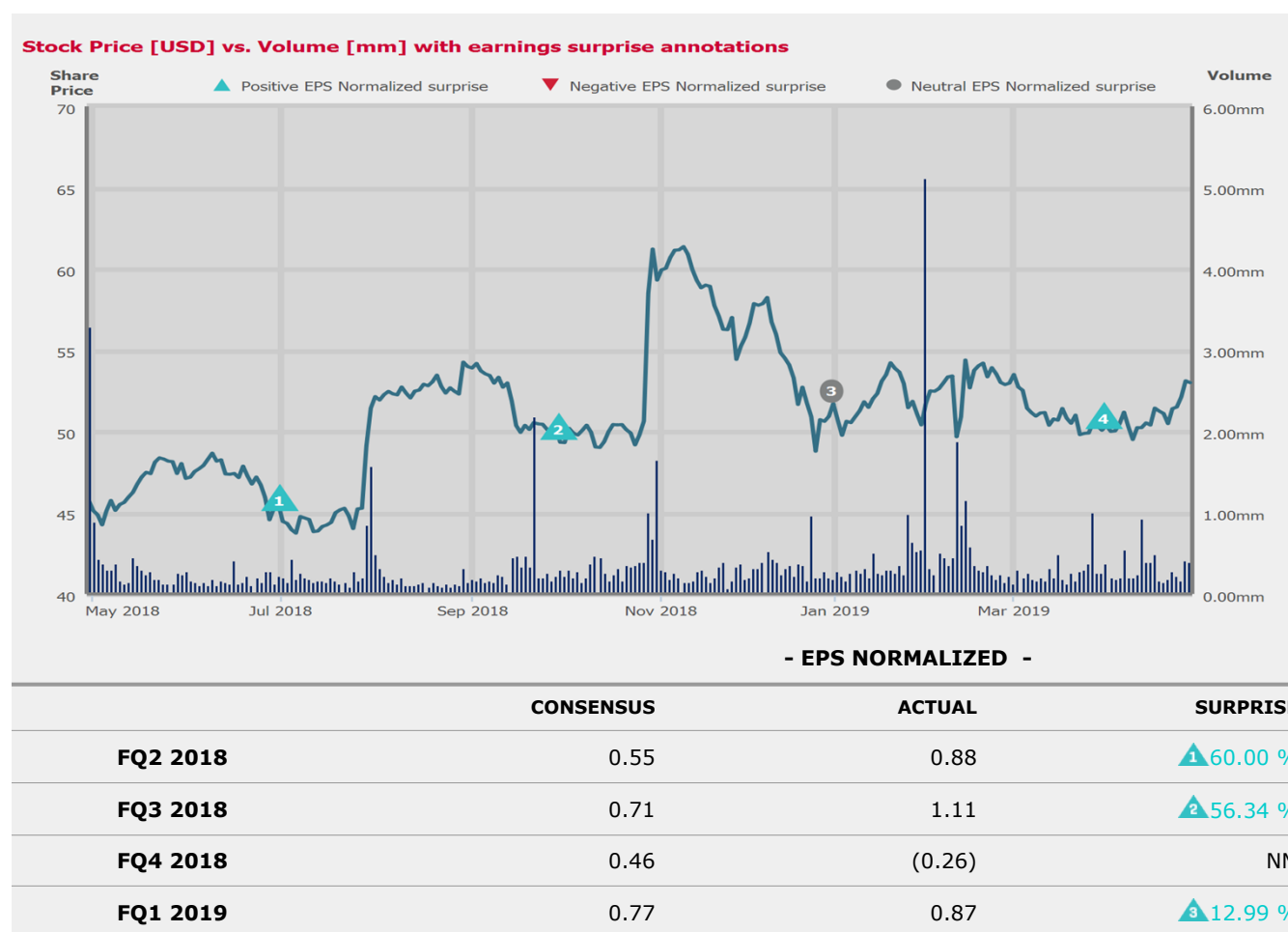
**Monday, April 29, 2019 5:00 PM GMT**

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.77	0.87	<span style="color: green;">▲ 12.99</span>	1.07	3.56	4.00
<b>Revenue (mm)</b>	917.25	916.45	<span style="color: red;">▼ (0.09 %)</span>	935.52	3722.85	3910.74

Currency: USD

Consensus as of Apr-04-2019 9:05 PM GMT



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# Call Participants

## EXECUTIVES

**Gabriel Tirador**

*President, CEO & Director*

**Theodore Robert Stalick**

*Senior VP & CFO*

## ANALYSTS

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc.,  
Research Division*

**Samir Khare**

*Capital Returns Management, LLC*

# Presentation

## Operator

Good morning. My name is Deidre, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General First 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 first -- 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

*President, CEO & Director*

Thank you very much. I would like to welcome everyone to Mercury's First Quarter Conference Call. I'm Gabe Tirador, President and CEO. On the phone, we have Mr. George Joseph, Chairman; Ted Stalick, Senior 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. Our first quarter operating earnings were \$0.87 per share compared to \$0.07 per share in the first quarter of 2018. The improvement in operating earnings was primarily due to a reduction in the combined ratio and an increase in after-tax investment income. The combined ratio was 97.3% in the first quarter of 2019 compared to 103.8% in the first quarter of 2018. The improvement in the combined ratio was primarily due to lower unfavorable reserve development in the quarter compared to the first quarter of 2018.

Unfavorable reserve development was \$1 million in the quarter compared to \$43 million in the first quarter of 2018. Rainstorms in California negatively impacted our homeowner results in the quarter, resulting in more than a 50% increase in homeowner claims reported compared to the first quarter of 2018. Gross catastrophe losses, primarily from the California rainstorms, were \$11 million in the quarter compared to \$9 million in the first quarter of 2018. Gross catastrophe losses of \$11 million in the quarter were reduced to \$5 million, as we recorded \$6 million in favorable reserve development from prior years' catastrophe losses.

Excluding the impact of unfavorable reserve development, catastrophe losses and seated reinstatement premiums earned, the combined ratio was 95.2% in the first quarter of 2019, compared to 97% in the first quarter of 2018.

To improve our combined ratio, we have been increasing rates in most states. In California, a 6.9% personal auto rate increase for California Automobile Insurance Company was implemented in March 2019, and a 6.9% personal auto rate increase for Mercury Insurance Company will be implemented in May of 2019. Collectively, these represent 2/3 of company-wide direct premiums earned. In addition, a 6.9% rate increase in our California homeowners line is pending approval from the California Department of Insurance. California homeowners premiums represent about 13% of direct company-wide premiums earned.

The expense ratio was 24.8% in the first quarter compared to 25.5% in the first quarter of 2018. The lower expense ratio was primarily due to a decrease in acquisition cost, primarily from lower average commissions and cost efficiency savings. Premiums written grew 6.4% in the quarter, primarily due to higher average premiums per policy and an increase in homeowners policies written. With that brief background, we will now take questions.

# Question and Answer

## Operator

[Operator Instructions] And you do have a question from the line of Christopher Campbell with KBW.

### Christopher Campbell

*Keefe, Bruyette, & Woods, Inc., Research Division*

I guess my first question is just I'm trying to understand all the math behind this subrogation sale of the fire receivables. So I guess could you just walk us through the math on that? Like how much were the cats impacted this quarter? How much were the reserves, and then premium growth? Because I think it's just -- I'm trying to make sure that I'm not double counting parts of the \$10 million pretax benefit within like the cats and reserves.

### Gabriel Tirador

*President, CEO & Director*

Sure. I'll go ahead and ask Ted. Ted, why don't you go ahead?

### Theodore Robert Stalick

*Senior VP & CFO*

Okay, Chris. So we had \$1 million of adverse development for the quarter. That includes \$6 million of favorable development from the cats from 2017 and 2018 cats. The \$10 million benefit is reinstatement premiums, a reduction in reinstatement premiums and also includes the benefit from the favorable development on those cats.

### Christopher Campbell

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Got it. So it's really just -- okay, so one way to think about it is it's \$11 million in cats this quarter if we just factor in what's happening with the storms, and then if we treat the adverse development. Or if we treat the subro sale as favorable development, then that gets you your \$1 million adverse because it would have been \$7 million absent that benefit this quarter. Is that the right way to think about it?

### Theodore Robert Stalick

*Senior VP & CFO*

That's correct.

### Gabriel Tirador

*President, CEO & Director*

Yes.

### Christopher Campbell

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Got it. And then, there would be an additional \$4 million pretax benefit from the benefit of lower reinstatement premiums, correct?

### Theodore Robert Stalick

*Senior VP & CFO*

Correct.

### Gabriel Tirador

*President, CEO & Director*

Well, I think the benefit this quarter was \$1.9 million from the reinstatement premiums. We would have normally booked the \$7.8 million in the quarter, and I think we booked \$5.8 million in the quarter. So the benefit in reinstatement premiums earned, I believe, was about \$1.9 million.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. And then where would the balance of the -- I guess it would be \$2 million, right, or -- because you have the \$6 million of favorable reserve development, that \$1.9 million rounded up to \$2 million for the lower reinstatement premiums. So where does the other \$2 million fall in the financials?

**Gabriel Tirador**

*President, CEO & Director*

What do you mean the other \$2 million?

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Well, I'm thinking in the press release, you have the -- there was a \$10 million pretax benefit from the subrogation sale of the receivables.

**Gabriel Tirador**

*President, CEO & Director*

Okay.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Yes. So if I subtract out the \$6 million of favorable reserve development that you got from selling those, and then the \$2 million reinstatement premiums, there's a balance of \$2 million.

**Gabriel Tirador**

*President, CEO & Director*

Ted, do you know what the answer is there?

**Theodore Robert Stalick**

*Senior VP & CFO*

We have -- the combination of the reinstatement and the favorable development is the \$10 million.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Got it. Great. And then, just I guess kind of more big picture California homeowners market after the recent fires, I guess, just how -- it sounds like you've got a 6.9% rate increase in the hopper. So I guess just beyond that, do you have like additional rate increases you're thinking about? And is there any regulatory risk that you may not be able to achieve those planned rate increases if there -- if the California DOI becomes concerned about homeowners insurance affordability out there?

**Gabriel Tirador**

*President, CEO & Director*

Well, as I mentioned on the prepared remarks, we have a 6.9% that has been pending for some time now and we're expecting that to come to a closure soon. We do expect to probably be filing after that 6.9% is approved. With respect to whether or not the Department of Insurance would approve that, they have a pretty formulaic process with a template that you insert your figures in that template, and if those figures -- if the output produces a rate increase, then you can take a rate increase. So at this point, we basically take a look at our indications on a quarterly basis. We have not yet finished our first quarter indications.

We'll be meeting on that in the next couple of weeks and taking a look at it. So I do -- I would expect that we would probably file again though after that quarterly indication meeting.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Got it. And then would you want to file immediately? Or I guess like how would the upcoming reinsurance renewals and any changes you might be making to the program or any potential rate increases that you could see, how would that -- how would the renewal of that reinsurance program factor into the timing that you would be looking at filing for an additional?

**Gabriel Tirador**

*President, CEO & Director*

It would not -- really, it would not -- it would be independent. We would file independently of whatever happens with the reinsurance.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Got it. And then, I guess just what changes are you thinking about for the program, like as you're getting into -- closer to...

**Gabriel Tirador**

*President, CEO & Director*

Well, we think that the \$300 million excess, \$200 million that we're going to purchase, more of that there for certain. We're pretty sure we'll buy more of that later. How much more, I don't know. Actually, Ted and our Chief Actuary and our chief underwriter are in the process. They're going to be going out meeting with the reinsurers pretty soon here. Ted, do you have any other comments on that?

**Theodore Robert Stalick**

*Senior VP & CFO*

No. Just that it will be -- we are planning on buying more limit than we currently have, but we're kind of just starting the process right now with the reinsurers.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Got it. And then auto rate increases, you got a 6.9% in Cal Auto and 6.9% in Mercury. I guess, as they get implemented, do you guys have any more rates that you're looking to take in those lines?

**Gabriel Tirador**

*President, CEO & Director*

I think, after these 2, I think that we feel pretty good, to be honest with you, Chris, where we're at after these 2, with a caveat that we take a look at our rates every quarter. And if we see that we need rate needs, we'll go ahead and take it. But we feel pretty good right now after the 6.9% that we just got with MIC and the 6.9% in Cal Auto as well. We'll monitor every quarter, but I will say, at this point, that I don't anticipate like filing right away in those 2 lines because we feel pretty good where we're at.

**Christopher Campbell**

*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. Do you feel good just in terms of the frequency, severity, pure premium trends you're seeing in auto? Should we expect it more to -- you guys to more pivot towards growth at this stage?

**Gabriel Tirador**

*President, CEO & Director*

Yes. I would say so. I would say so. There's been less rate action going on in the industry, too, more recently. So when you take a look at our underlying combined ratio in our auto, and prior past-year auto in California, we feel pretty good where we're at, especially in light of the fact that we just got these 2 6.9%. So yes, more of a growth stance.

**Operator**

[Operator Instructions] And we do have a question from the line of Samir Khare.

**Samir Khare**

*Capital Returns Management, LLC*

Just a quick question about the subrogation as well. What is the gross amount of subrogation proceeds you received? And what were the total gross loss amounts for the 3 fires that the subrogation was based off of?

**Gabriel Tirador**

*President, CEO & Director*

Ted, can you handle that?

**Theodore Robert Stalick**

*Senior VP & CFO*

I didn't get the first part of your question.

**Samir Khare**

*Capital Returns Management, LLC*

I was just asking about the gross amount of subrogation proceeds you received.

**Theodore Robert Stalick**

*Senior VP & CFO*

So the subrogation is -- the assignment agreement is confidential. So we're not at liberty to discuss the terms of the agreement. The majority of the subrogation benefits went back to our reinsurers, I can tell you that.

**Samir Khare**

*Capital Returns Management, LLC*

Okay. And I just want to see where the balance of gross losses for the Camp Fire stand? Is that around \$200 million or \$201 million?

**Theodore Robert Stalick**

*Senior VP & CFO*

After the subrogation?

**Samir Khare**

*Capital Returns Management, LLC*

Yes.

**Theodore Robert Stalick**

*Senior VP & CFO*

I think it's between \$140 million and \$150 million.

**Operator**

[Operator Instructions] And we have no further questions at this time.

**Gabriel Tirador**



*President, CEO & Director*

Well, okay. Thank you, everyone, for joining us this quarter, and we look forward to speaking to you next quarter. Thank you very much.

**Operator**

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

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