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Mercury General Corporation NYSE:MCY

FQ2 2013 Earnings Call Transcripts

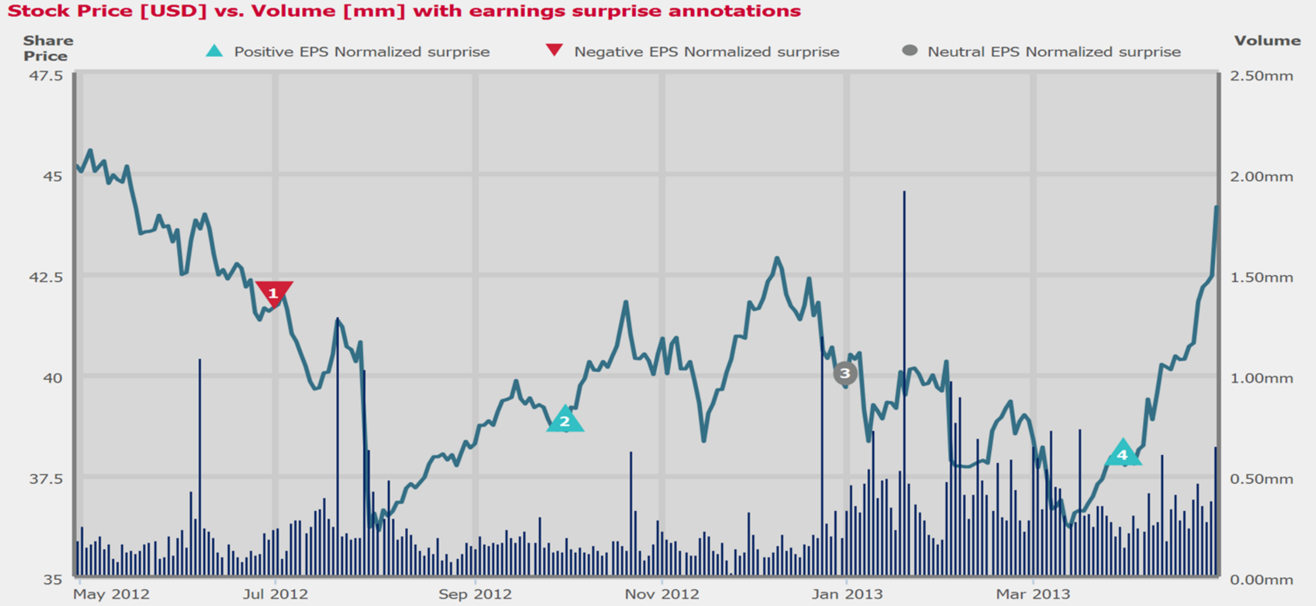
Monday, July 29, 2013 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.61	0.63	▲3.28	0.61	2.55	2.69
Revenue (mm)	686.34	665.48	▼(3.04 %)	712.28	2764.00	2909.90

Currency: USD
Consensus as of Jul-29-2013 1:38 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	0.67	0.19	▼1 (71.64 %)
FQ3 2012	0.56	0.62	▲2 10.71 %
FQ4 2012	0.23	(0.17)	NM
FQ1 2013	0.47	0.69	▲3 46.81 %

Call Participants

EXECUTIVES

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good afternoon. My name is Brent, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Second 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. Please go ahead, sir.

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; Robert Houlihan, Vice President and Chief Product Officer; and John Sutton, Senior Vice President, Customer Service. Before we take questions, we will make a few comments regarding the quarter.

I am pleased to report our second quarter operating results were much improved as compared to the second quarter of 2012. Our second quarter 2013 combined ratio was 98.7% compared to 104.5% in the second quarter of 2012. Our second quarter results were negatively impacted by $13 million of pretax catastrophe losses, primarily from Midwestern storms, including the category F5 tornado that struck Moore, Oklahoma on May 20. Excluding catastrophe losses, our second quarter combined ratio was 96.8% compared to 103.2% in the second quarter of 2012. There was no prior year reserve development in the quarter.

In California, the California Department of Insurance approved our 6.9% rate increase in our nonstandard California company, which represents approximately 23% of our California private passenger auto business. The new rates went into effect on July 21. The California Department of Insurance is currently reviewing our 6% rate increase in our preferred auto California company. We expect to have an indication from the department on this pending filing in the next few weeks.

As we previously reported, the California insurance commissioner accepted a decision from an administrative law judge to reduce our homeowners rates by approximately 5.5%. We strongly disagree with the administrative law judge's proposed decision. In fact, our most recent results clearly demonstrate that the judge's forecasted trend selections were significantly too low for our largest homeowners forum. We are contesting the proposed rate reduction in Superior Court, including our right to earn a fair rate of return. The case is expected to be heard in November.

In connection with our challenge, the Superior Court judge recently denied our motion to stay the rate reduction pending the outcome of the case. Accordingly, we reduced our California homeowners rates an average of 5.5% on May 11. In addition to the Superior Court proceedings, we filed for a 6.9% rate increase that reflects our more recent results. The insurance commissioner has issued a notice of hearing on this rate filing, and the hearing is scheduled to commence in the fall.

Our results in the quarter were helped by the continued improvement of our underlying operations outside of California. Excluding the impact of our $13 million catastrophe charge, our operations outside of California posted a combined ratio under 100% for the second consecutive quarter. Over the past few years, we have taken significant rate action in most states outside of California, and the impact of those rate actions is having a positive impact on our results.

Our premiums written growth slowed on a sequential basis from 4.9% in the first quarter of 2013 to 1.8% in the current quarter. Our expectation is our top line will be under pressure going forward as new business private passenger sales and retention levels outside of California have declined due to rate increases, and the California market remains very competitive.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

My first question would be on the -- kind of on the heels of your nonstandard auto approval. And I'm just kind of curious if, hopefully, the approval there on the 6.9% rate increase would maybe give you some more confidence in getting approval on the preferred auto request, if that would make sense.

Gabriel Tirador
Chief Executive Officer, President and Director

Robert, you want to handle that question?

Robert Houlihan
Chief Product Officer and Vice President

Obviously, the department agreed with -- or came up with an indication that, I believe, supported our rate request on our nonstandard product. So that was a positive development. But each filing is separate and considered on its own, and we haven't had a meeting yet with the department to review their indication on the MIC filing. So it's difficult, at this time, to assess what the department's outcome will be on that particular rate request.

Gabriel Tirador
Chief Executive Officer, President and Director

I think I would agree with that assessment. Each filing stands on its own, and we're going to have to just wait and see, Vincent.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, perfect. And you guys -- I know you've mentioned this quarter and in the past about the California market on the auto side being competitive. And so I'm just curious if you think there are really any changes coming down the pipe just with several comments coming from some competitors, like Progressive or Travelers, just making comments about ramping up the rate competition. So would that kind of imply that status quo competition levels remain? Or do you think that we kind of ramp-up the amount of just rate decreases coming from some of those guys and others competitors that would maybe challenge some retention levels?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think here in California, we haven't really seen any rate decreases. California is our largest market. We have seen some carriers tighten some underwriting here in California. Outside of California, I think, by and large, we've seen more rate increases than we have rate reductions. I think you're referring to the comments that Travelers has made that they're going to try to become more competitive, and they're addressing their underlying cost structure to become more competitive. I mean, we're going to have to wait and see what comes of that. But as far as -- our approach outside of California has been to improve our profitability, number one, and we've done that. And now we're trying to address the top line growth outside of California. As I mentioned in the previous call, in the first quarter of this year, we took steps to improve our cost structure, and we did the hub consolidation and also taking a look at other costs outside of California. So it's important, obviously, to offer a competitive product, you have to have a competitive cost structure. And that's what apparently Travelers has been mentioning in the previous call and something that I think all carriers are taking a look at.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

That makes good sense to me. Just one last one, and I'll re-queue. So from an auto loss cost standpoint, it kind of looks like trends maybe haven't been as problematic more recently as kind of what they were in the previous year. In some -- I'm just curious if you guys are seeing that or if there's been any notable trends of acceleration or deceleration from what you're seeing. And I guess also, from a reserving standpoint, it looks like things may be developing kind of along what you guys have expected, which maybe points to just stable loss cost trend. So again, curious of any thoughts that you guys may be seeing.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

This is Ted. We basically experienced low to -- low-single digit frequency and severity in California, which is about what we've expected. And as you remember, we took a 4% rate increase last October. So that's kind of keeping up with the trend. Outside of California, it's varying quite a bit by state. But if you take out the caps [ph], it's been a fairly benign loss cost environment, and it's been within our expectations.

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

I guess 2 questions, one a follow-up on Travelers. I think they were complaining about the impact on their auto business from agents using comparative raters. Are you seeing that? Is that a material impact for you? And then also, if you could talk about just what the differences you're seeing between portfolio yield and the new money yield.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I mean, I think, from the comparative rater standpoint, there's no question that in the past 5, 10 years, more and more agents are using comparative raters, which leads to more price transparency. The Internet leads to more price transparency, and price matters in this business. So does it have an impact? Yes, I think it does have an impact. It varies by state. But the more the agents use these comparative raters, the more quotes they get from different carriers, so -- and price is a big factor. So it does have an impact, and I would say that the impact today is more than it was 5 or 10 years ago. Robert, do you want to add to that or...

Robert Houlihan
Chief Product Officer and Vice President

No, I think it's a gradual change over the last 10 years you'll see in that process. I agree it's becoming a market where many customers use a commodity price drives business, and the comparative raters make the price differences more transparent to consumers.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. And then the second question on the new money, Chris is not with us this morning. But I think rates in the second quarter -- at the end of the second quarter backed up a little bit, and we were able to get actually yield to munis that were more attractive to our current book yields, slightly more attractive to the current book yields. So the new money that we put into place in the second quarter, a lot of that new money was actually placed at a little bit higher yield than our book yields.

Operator

And next, you have a follow-up question from the line of Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Just real 2 quick ones. From the data that I'm looking at for California, it looks like the weather was pretty good this quarter versus 2012 and 2011. So obviously, you guys have a much better feel for what actually happened than I would from the high-level data that I look at. So I'm just kind of curious if you do have a comment on California weather-related frequency and whether that meaningfully impacted your loss ratio this quarter.

Gabriel Tirador
Chief Executive Officer, President and Director

I don't think the weather was much different year-over-year on a quarter basis. I mean, I think the frequency in California was up slightly.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, which is consistent with what the trend has been, so I don't think weather was a big impact this quarter.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. Last year, you might want to recall, Vincent, that we booked a great deal of reserve development in the quarter. I forget the number off the top of my head but it was...

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

2012, over $20 million.

Gabriel Tirador
Chief Executive Officer, President and Director

Over $20 million in the second quarter of 2012, and that was a large reason for the increase in the loss ratio back in the second quarter of '12.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's really helpful. I just looked at the NOAA storm counts, which I'm always curious if these are actually telling me the right thing. So I think with that, it was like a 67% reduction in California storm counts. So always good to get the actual feet on the street kind of perspective.

Gabriel Tirador
Chief Executive Officer, President and Director

It doesn't rain much in the second quarter here in California. I mean, it doesn't really rain much at all here.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

67% is a big one.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, 67%, as you know, has been a lot.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Got you, it's a very good point. And then the last one I have, in just some of your comments earlier in your prepared remarks about homeowners, and the one thing I'm kind of wondering is if there's any risk to having your homeowners rates sort of bounce around. And really, kind of where I'm kind of coming from on that is I'm just curious if with below what you'd kind of want from a homeowners rate, if that kind of puts you at risk for getting some unattractive business, which, obviously, once you kind of get your rates sorted out, you can deal with that. But do you think that's a real big concern or not something that we should worry about?

Gabriel Tirador
Chief Executive Officer, President and Director

I'm not sure what you mean by unattractive business. I mean, I think we had to implement rates that we saw -- we feel are too low for us to get an adequate return, which includes this 5.5% reduction. But we had filed -- before the 5.5% reduction, we had filed for a 6.9% rate increase because we felt that the line for us to get an accurate rate of return needed that rate increase. So now our application counts after the 5.5% rate reduction really haven't changed much in our homeowners line. So it's not like we're getting -- to your question, potentially, are we getting unattractive business, however you're defining that. I'm not sure how you're defining that, but the answer is well, the volume hasn't really changed that much, but we do feel that we need the higher rates in this line of business.

Operator

Sir, we have no further questions in the queue at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Great. Well, I'd like to thank everyone for joining us this second quarter, and we hope to bring some good results in the third quarter as well. Thank you very much.

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