S&P Capital IQ

CONTENTS

Mercury General Corporation NYSE:MCY

FQ4 2013 Earnings Call Transcripts

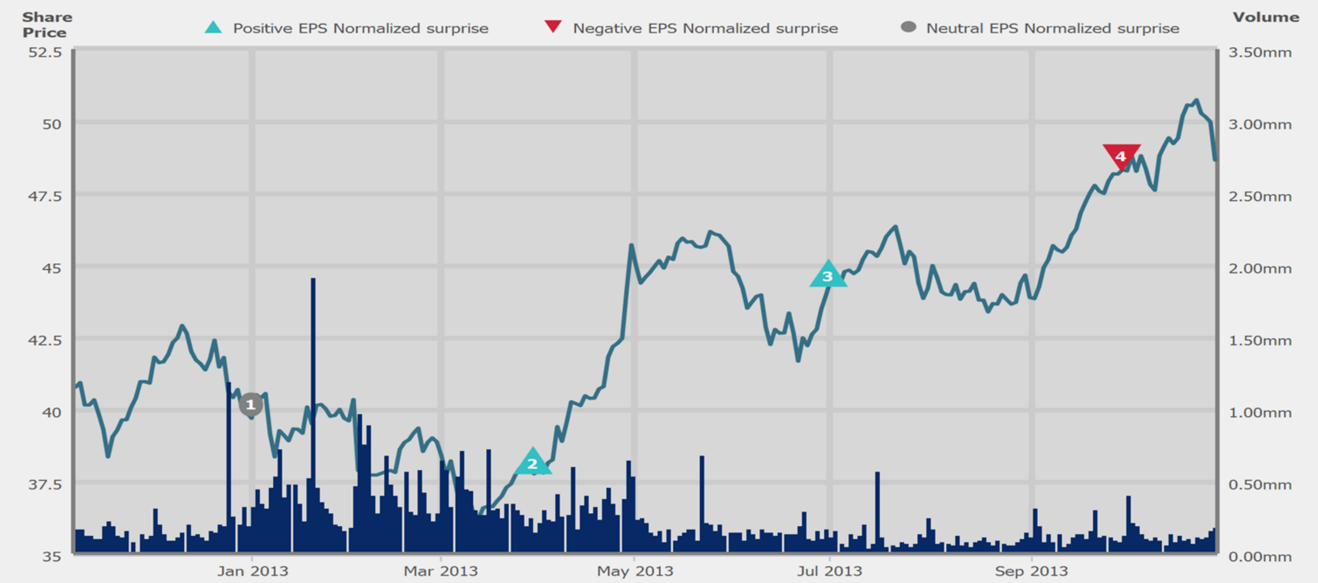
Monday, February 10, 2014 6:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.53	0.33	(37.74 %)	0.68	2.38	2.18
Revenue (mm)	661.48	668.12	1.00	700.85	2722.36	2729.00

Currency: USD
Consensus as of Feb-10-2014 2:32 PM GMT

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



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	0.23	(0.17)	NM
FQ1 2013	0.47	0.69	1 46.81 %
FQ2 2013	0.61	0.63	2 3.28 %
FQ3 2013	0.64	0.53	3 (17.19 %)

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 morning. My name is Candice, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Quarterly Conference Call. [Operator Instructions]

This conference call may contain 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 fourth quarter conference call. I'm Gabe Tirador, President, 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 Chris Graves, Vice President and Chief Investment Officer.

Before we take questions, we will make a few comments regarding the quarter. Our fourth quarter operating earnings were $0.33 per share compared to an operating loss of $0.17 per share in the fourth quarter of 2012. Premiums written grew 2% in the quarter, primarily due to higher average premiums per policy, as a result of rate increases. Operating earnings improved during the quarter primarily because our fourth quarter 2012 results were negatively impacted by Hurricane Sandy and adverse loss reserve development.

For the entire year, our operating earnings were $2.18 per share compared to $1.34 per share in 2012, a 63% improvement. Premiums written for the year were up 2.9%. The improvement in 2013 was largely the result of improved profitability in states outside of California due to rate and underwriting actions taken over the past few years, fewer catastrophe losses and less adverse development on prior-period loss reserves. For the full year, we recorded $3 million of adverse reserve development compared to $42 million in 2012.

Although our year-over-year results showed progress, our quarterly operating results deteriorated on a sequential basis from $0.53 per share in the third quarter of 2013 to $0.33 per share in the fourth quarter, making the fourth quarter our worst-performing quarter of the year. The combined ratio was 102.5% in the fourth quarter compared to 99.2% in the third quarter of 2013. The fourth quarter is typically our worst-performing quarter due to weather and seasonal driving, and we usually see a several point deterioration in the loss ratio. This year, in California, we had unusually good weather during the fourth quarter. And consequently, our California private passenger auto loss ratio deteriorated only slightly. The loss ratio was about 1 point higher in the quarter than for the entire year.

In addition to the slight decline in our California private passenger auto results, other factors contributed to the deterioration of the fourth quarter 2013 combined ratio from the third quarter of 2013. These include an increase in our 2013 accident year severity estimates for bodily injury and PIP coverages in New York and Florida and worse homeowner results in California. In addition, we recorded $5 million of adverse reserve development during the quarter.

For the full year, excluding catastrophes, our operations outside of California posted a combined ratio under 100%. Although our margins outside of California have improved dramatically over the past few years, premiums written outside of California have declined, as rate increases affected our retention levels and limited our ability to generate new business.

To improve our cost structure, last year, we announced the consolidation of our claims and underwriting operations located outside of California into hub locations in Florida, New Jersey and Texas. In addition, other expense reduction measures have been taken. These changes to our cost structure, coupled with our review of loss indications, will allow us to reduce private passenger auto rates in 6 of our markets in the first quarter of 2014. We believe the reduction in rates in these 6 markets will improve our competitive position and will help grow our new business sales outside of California. Although we expect our new business sales outside of California to improve as a result of our rate reductions, we don't expect premiums written to grow in the near term as it will take some time for new business sales to impact premiums written.

I am pleased to report that the California Department of Insurance approved a 6% rate increase in our preferred company, California Company [ph], which represents approximately 78% of our California private passenger auto premiums. The new rates went into effect on January 1, 2014. In addition, the California Department of Insurance approved an 8.25% rate increase in our California homeowners business effective January 2014. Last December, we filed for a 6.9% rate increase in our nonstandard California company. This rate increase is currently being reviewed by the California Department of Insurance.
As we look forward to 2014, our expectation is that our 2014 results will improve over 2013, as both our auto and homeowners rate increases in California begin to earn in. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from Vincent DeAugustino with KBW.

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

First question is -- would be on the auto rate decreases that you'd mentioned within the 6 markets. I was just wondering if you could comment perhaps on the magnitude and then what markets this would represent or at least what percentage of premiums these markets in totality would be?

Gabriel Tirador
Chief Executive Officer, President and Director

To your first question, the range is from a low of 3% to a high of 14%, I believe, over double digits, so there's a quite a bit of range, with respect to the decrease. And the 2 biggest markets that we're reducing rates is Florida and Texas. In Florida, the reduction was about 10%, and in Texas, I think it was a similar amount. Florida and Texas represent our 2 biggest markets outside of California.

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

Okay. And that -- so just with the press release noting that Florida was kind of this year a bit of a hurdle with the reserve element, I assume that given the rate movement, that would kind of imply that you guys are pretty comfortable with Florida for 2014, just given the rate intentions there?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, one of the reasons that the Florida results deteriorated had to do with some old mitigation [ph] that the industry loss, and we had to set up some reserves for that. Ted, you want to elaborate on that?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes. The 2008 through mid-2012 accident years for the PIP coverage, there were some adverse cases that went against the industry on a permissive versus mandatory issues for PIP, and so the company went back and reevaluated those accident years, and that's where the development came from. Going forward, that's not really an issue, and that's why we were able to reduce the rates.

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

Okay, that's good. The color there's really very helpful. As far as kind of changing gears a little bit, a question with just the pending case that's in front of the ALJ right now. And what I'm kind of curious on is, from what I understand, one of the potential outcomes on the table would be suspension of Mercury's California license, if the case kind of doesn't go in your favor. And so for me, that seems pretty drastic. And I'm just wondering is that a real possibility, or is that just kind of the department pounding the table at this point?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think that the likelihood of that happening is not high. In my opinion, that's something that they put into the notice of noncompliance, which is what I think that you're referring to. Vincent, I don't think that the likelihood of that occurring is very high.

Vincent M. DeAugustino

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

Okay, that's good. And as far as just reading through the brief, they talked about potentially about 50 to 100 basis points kind of the total amount that was thrown out. Is that something that we should think about, again, if it doesn't go against -- if it doesn't go in your favor kind of as the maximum kind of adverse scenario then, just to kind of frame the magnitude on our end?

Gabriel Tirador
Chief Executive Officer, President and Director

I'm not sure what you're referring to as a couple of hundred basis points, Vincent, to be honest with you. With respect to this -- to the notice of noncompliance, I'm not familiar with what you're referring to, the couple of hundred points.

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

Yes, sorry. Sorry, it wasn't a couple of hundred points. It was 0.5% to 1% of the total calculated fine that I believe was at $1.8 billion. So the math would work out to be somewhere between, I guess, max, $18 million-type of thing. So I'm just trying to look at the brief and engage how bad could it be. Just trying to get some insight even though you might not be able to handicap it just yet.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. I mean, we feel pretty good about the case. Overall, it's hard to, as you point out, handicap. I will note that this case has been thrown out once before, and it went back to the Commissioner, and then the Commissioner sent it back to the ALJ to hear the case. Overall, we feel pretty good where we're at and our defense of the case. So I -- it's hard to handicap what's going to happen, but we feel good about where we stand right now.

Operator

[Operator Instructions] And your next question comes from Alison Jacobowitz with Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Couple of questions. I was wondering if you could talk about what other actions you're taking in the homeowners business besides raising prices to improve those results. And I was just wondering if you could talk a little more about the expense ratio, given the restructuring, and how you're thinking about that going forward, and maybe other actions you're taking there, generally, where you expect to see that going.

Gabriel Tirador
Chief Executive Officer, President and Director

Robert, you want to take on the homeowner -- some of the things that we've done on the homeowners side?

Robert Houlihan
Chief Product Officer and Vice President

Yes, we've done several things, Alison. In addition to the rate increases, we've also instituted some risk management measures. We look at a number of metrics relative to the concentration of business. When the concentration goes above thresholds that we consider appropriate, we require an action plan to address that. We've also entered into the reinsurance market last year as well.

Gabriel Tirador
Chief Executive Officer, President and Director

And with respect to the expense ratio and some of the other things that we've done, we have modified our commission structure outside of California to pay our agents, basically, a competitive commission based on the individual relationship the agent has with the company. Currently, we pay above-average industry commissions. And with this change, our commissions will remain very competitive, but our expectation is that overall commissions are expected to decline.

Operator

And we have no further questions at this time. I'll turn the call back to our presenters.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we would like to thank everyone for visiting with us today in the fourth quarter conference call. We hope to bring better results in the first quarter of 2014. Thank you very much.

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