S&P Capital IQ

CONTENTS

Mercury General Corporation NYSE:MCY

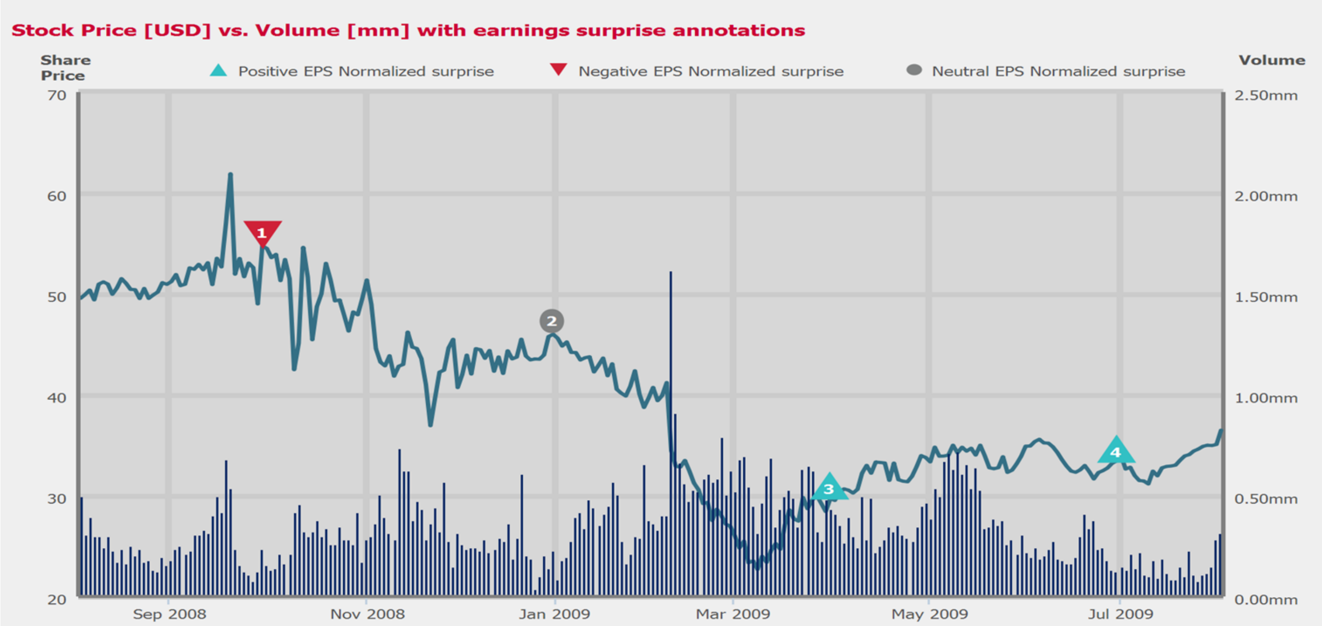
FQ3 2009 Earnings Call Transcripts

Monday, November 02, 2009 6:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2009-			-FQ4 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.66	0.84	▲27.27	0.67	3.18	2.88
Revenue (mm)	644.50	662.76	▲2.83	606.20	2557.75	2496.35

Currency: USD
Consensus as of Nov-02-2009 4:33 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2008	0.90	0.72	▼1 (20.00 %)
FQ4 2008	0.78	(0.48)	NM
FQ1 2009	0.64	0.83	▲2 29.69 %
FQ2 2009	0.70	0.86	▲3 22.86 %

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

Dean Evans
KBW

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Presentation

Operator

Good afternoon. My name is Regina 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, CEO of Mercury General. Mr. Tirador, you may begin the conference.

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 and CFO; Chris Graves, Vice President and Chief Investment Officer; and Robert Houlihan, Vice President and Chief Product Officer. On the phone, we have Ron Deep, Vice President of the Southeast region.

Before we take questions, I will make a few comments regarding the quarter. Our third quarter 2009 results improved significantly as compared to the third quarter of 2008. Year-over-year, our combined ratio improved from 102% in the third quarter of 2008 to 96.4% in the third quarter of 2009. The primary driver for the improved year-over-year results during the quarter was due to positive reserve development. Year-to-date, we have recorded $40 million of positive reserve development on prior accident years compared to $46 million of adverse development in 2008. Generally, we are recording increases in severity in the mid single digits and reductions in frequency in the low single digits.

In addition, we continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. During the quarter, we introduced a new rating plan in Pennsylvania, Texas and Oklahoma and filed for rate increases in several states.

In California, we expect to have our pending auto refine with the Department of Insurance approved in the fourth quarter. The pending fine include a small rate increase. In addition, the fine introduces, among other things, new discounts and roadside assistance coverage. We plan on continuing to make additional improvements to our auto products in order to achieve our targeted combined ratio, as well as improve our pricing sophistication. We also plan on introducing a new homeowners products in Virginia and New Jersey during the fourth quarter.

Our premiums written declined 4.7% during the quarter to $663 million. This was an improvement over the 8% and 6.8% decline in the first and second quarter, respectively. Despite the improvement in the rate of decline, we expect our growth rate for the next quarter to be negative in the low to mid single digits. Despite the challenging environment in some of the states where we have implemented new rating plans, we have observed nice increases in new business submissions. We also expect a new rating plan in California, once implemented to provide a lift to our new business submissions.

We have begun our deployment of our new finance sale system Mercury First to Florida. This marks the third state we have deployed Mercury First to. Our plan is to roll out Mercury First to California early in 2010. Feedback from our agents on the new system has been positive.
Lastly, on the investment side, asset valuations improved significantly during the quarter, generating over $170 million in capital gains during the quarter. The overall investment portfolio market value is now the same as the cost basis. Our capital position has also improved with book value per share of $32.29, up over 18% from December 31, 2008. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Dean Evans with KBW.

Dean Evans
KBW

I was wondering if you could give a little more update, as you spoke about the rate filings, sort of what they've been in some of the various markets and states?

Robert Houlihan
Chief Product Officer and Vice President

Yes, and most of the filings have been updates to our auto product changing the tiering and the product changing some of the relativities trying to make us more broadly competitive. We've also, over the course of the year been introducing new homeowners. We've rolled that out in Arizona to date.

Dean Evans
KBW

How about on the rate, particularly California? You did mention that the recent rate filing was for a slight positive?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, in our preferred company, Dean, which is probably 70%, 80% of the business. It's about a 1.5% increase, I think. And in the non-standard companies, it's about 2%.

Dean Evans
KBW

On another kind of topic, a competitor of yours that does business in Florida, on their call discussed the issue of sinkholes as property losses. I was wondering if you're seeing anything in that arena or kind of how you think about that?

Gabriel Tirador
Chief Executive Officer, President and Director

That's a significant issue, we have seen an increase in sinkhole losses. We're actually addressing that. We have a fine right now and with the Florida department where we're increasing our rates in a double digit area. We're also fined for a change in the policy where we will only be responsible for catastrophic sinkhole coverage, with the option to buy regular sinkhole coverage as required by the law. Keeping in mind that we're not really writing any new business right now and Florida homeowners but sinkhole is a major problem in Florida. Specifically in the St. Petersburg, Tampa area, there are some area that are more prone to sinkhole than others.

Operator

Our next question comes from the line of Michael Phillips with Stifel Nicolaus.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Last quarter you gave a $31 million of a favorable development that included 14 of development from accident period 2009. Any such development this quarter in the 2009 accident period?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, you'll notice in our release we went back to our practice of just reporting our accident year loss reserve development, which include losses from December 31 '08 and prior but does not include development in the third quarter on losses incurred during quarters 1 and 2 of the current 2009 accident year.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

That's unlike last quarter, correct?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, and we went back to reporting it this way because many of our investors and analysts were just using the accident year development figures and ignoring the development on losses incurred within the year. Which is kind of consistent with how the company evaluates our reserved development more on accident-year basis rather than an accident-quarter basis. So that's the reason why we changed the disclosure. I'll just give you some general feedback for the 2009 accident periods. We are experiencing a pretty significant positive development within the current year, which relates primarily to the material damage coverages, which are experiencing flat to negative severity trends, and then in addition, the BI [Bodily Injury] severity reductions for 2008 have a favorable impact on our severity picks for BI for 2009. So in a nutshell, we are seeing significant positive development within the current accident period.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Anyway you can help us put some metrics around? In your disclosure, you talked about some of the reasons, well you see the severity is down, but also the fewer late reported claims, can you help us -- any metrics you can put around that, kind of what you're used to seeing after the end of an accident period and what you're seeing now for '08?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, for California bodily injury, for example, we'll see anywhere from, say, 5% to a maximum maybe 10% late reported claims. And for the '08 accident year, the number is less than 5%. So when you're looking at how we think those accounts are going to develop out, maybe you estimate somewhere in the middle, around seven or eight, and they come out at three or four, and at $8,000 a claim, it adds up.

Gabriel Tirador
Chief Executive Officer, President and Director

Most of the development is a result of the severity. Most of it is a result of change in severity estimates and not frequency estimates. But I will warn you that there is seasonality in some of the numbers. For example, in the fourth quarter, we usually have an uptick in frequency in the fourth quarter because of weather and holiday's arriving. So quarter to quarter, you can have some fluctuations as I guess what I'm saying, as an example, we expect that in the fourth quarter of this year.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Gabe, in your opening comments you talked about the new rating plan in California and how you expect that to provide uplift to new busines submission. Can you tell us what's in that plan that allowed you to think that?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we're going to be allowing for a discount or providing a discount, education discount for anybody who has a bachelor's degree. And they will be getting a 10% discount. And we think that's going to provide us with some potential for increase in new business submissions. In addition to that, we're also going to be offering, at no extra cost, roadside assistance coverage for any policy that has comp and collision. So the combination of those two factors and there's some other minor things that we're changing with the actual rate filing, but those are the two biggest.

Operator

[Operator Instructions] Our next question comes from the line of Alison Jacobowitz with Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I just want to follow up and just make sure I'm doing my math right then, the $40 million favorable reserve development from prior years to date, if I did everything right, just $2 million prior-year favorable development in the quarter?

Gabriel Tirador
Chief Executive Officer, President and Director

That's correct.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

If you could. I hear what you're saying about the prior-period development not wanting to give the year-to-date number for the current year, but can you give us some, I don't know, is it possible then for you to just give us color on what the accident year, what accident year you are seeing in your business run at year-to-date? I don't think I saw it in the press release.

Gabriel Tirador
Chief Executive Officer, President and Director

I won't be giving the numbers.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Maybe in general range, I don't know. If you're not comfortable, it's fine.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

For the year-to-date combined ratio on an accident-period basis, it's about two points worse than what's showing in the nine months. Because we have $40 million of positive development but $2 billion of earned premium.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

But I guess what I'm trying say -- sorry, I wasn't really very clear, are you seeing it trend up or trend down as the quarters progress or is there not much change to be meaningful?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I would just say that in California, which is our biggest state and these numbers vary by state obviously, but since California is our biggest state, I would say that we're in the mid-90 accident year range in California, 95 or so.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And has it been fairly stable or has it been?

Gabriel Tirador
Chief Executive Officer, President and Director

It's been fairly stable.

Operator

[Operator Instructions] And I'm sure that we no have further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, if that's the case, I'd like to thank everybody for calling in today's call and we look forward to talking to you next quarter.

Operator
Ladies and gentlemen, this does conclude today's conference call. Thank you all for participating. You may now disconnect.