S&P Capital IQ

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Mercury General Corporation NYSE:MCY

FQ2 2016 Earnings Call Transcripts

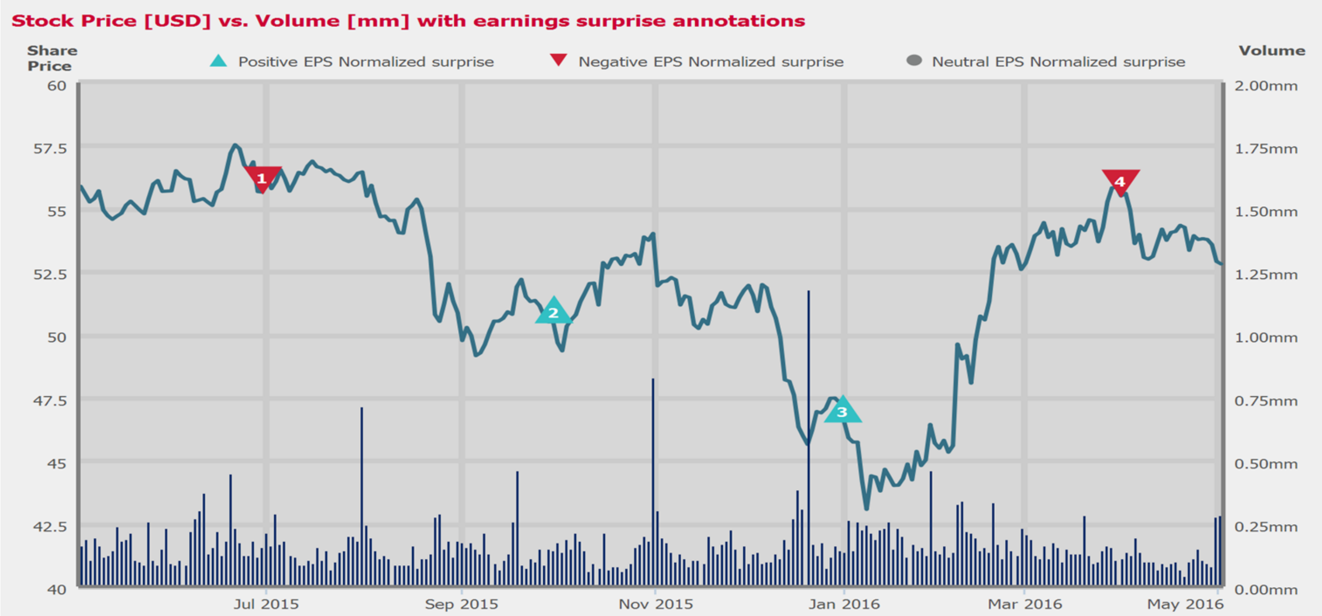
Monday, August 01, 2016 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.59	0.35	(40.68 %)	0.66	1.93	2.82
Revenue (mm)	779.60	781.67	0.27	827.21	3188.75	3340.50

Currency: USD

Consensus as of Jul-15-2016 7:35 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	0.67	0.64	(4.48 %)
FQ3 2015	0.58	0.59	1.72 %
FQ4 2015	0.45	0.52	15.56 %
FQ1 2016	0.68	0.13	(80.88 %)

Call Participants

EXECUTIVES

Gabriel Tirador
Chief Executive Officer, President and Director

ANALYSTS

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

Presentation

Operator

Good afternoon. My name is Maria, 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 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; and Robert Houlihan, Vice President and Chief Product Officer. On the phone we have Chris Graves, Vice President and Chief Investment Officer.

Our Chief Financial Officer, Ted Stalick, is traveling and is therefore unable to be on the call.

Before we take questions, we will make a few comments regarding the quarter. Our second quarter operating earnings were $0.35 per share compared to $0.64 per share in the second quarter of 2015. The deterioration in operating earnings was primarily due to an increase in the combined ratio from 98.5% in the second quarter of 2015 to 101.7% in the second quarter of 2016.

Our results in the quarter were negatively impacted by $22 million of unfavorable reserve development on prior accident years, $11 million of catastrophe losses and $2 million in severance payments related to a previously announced reduction in force.

The majority of the unfavorable reserve development in the quarter came from our California bodily injury coverage. The development occurred across multiple accident years with about $10 million relating to accident year 2015 and the remainder to older years. Catastrophe losses in the quarter were primarily from severe storms in Texas. Excluding the impact of unfavorable reserve development on prior accident years, catastrophe losses and severance payments, the combined ratio was 97.2% in the quarter.

In California, we recorded an increase in personal auto severity in the high single-digit range during the quarter as compared to the second quarter of 2015. California prior passenger auto frequency was up slightly in the quarter as compared to the second quarter of 2015.

This year, for our personal auto business in California, we implemented a 5% rate increase in late March 2016 for Mercury Insurance Company and a 6.9% rate increase in June 2016 for California Automobile Insurance Company. Personal auto premium in Mercury Insurance Company represents about half of our company-wide premiums earned, and California Automobile Insurance Company represents about 15% of our company-wide premiums earned.

Outside of California, our results were negatively impacted during the quarter by catastrophe losses, primarily related to severe storms in Texas. Increasing loss cost trends and higher loss ratios that come with an increase in new business also negatively impacted our results during the quarter.

To address profitability outside of California, we are increasing rates and tightening our underwriting. Excluding the impacts of catastrophe losses, the combined ratio outside of California was about 100.3% in the quarter compared to 99.8% in the second quarter of 2015.

The expense ratio in the quarter declined to 25.4% from 27.3% in the second quarter 2015. The decrease in the expense ratio was primarily due to lower advertising expenses, lower average commissions and a reduction in profitability-related accruals. Net advertising expense in the quarter was $8.6 million compared to $12.1 million in the second quarter of 2015.

Premiums written grew 6.6% in the quarter primarily due to higher average premiums per policy. Company-wide, private passenger auto new business applications submitted to the company decreased 7.9% in the second quarter of 2016, as we focused on improving profitability in our private passenger auto line.

Company-wide, homeowner's applications increased to 1.4% in the second quarter of 2016. In California, we posted premiums written growth of 7.8%. Outside of California, premiums written grew 1.3% in the quarter.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Greg Peters of Raymond James.

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

I think in your first quarter call you mentioned the possibility of getting or looking for more rate in the California Auto Insurance Company. I'm curious with the second quarter results, if it's changed your perspective on Mercury Insurance Company in California?

Gabriel Tirador
Chief Executive Officer, President and Director

We still haven't made a decision on Mercury Insurance Company. We believe our rates, even after the second quarter, are in line, but we're going to be following the trends very closely. And it is -- there is a possibility that we may be filing for a small rate increase in Mercury Insurance Company. In Cal Auto, we have filed for a 6.9% rate increase. That's already been filed.

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

Right. And that's on top of what you've already achieved or what you announced in this call, correct?

Gabriel Tirador
Chief Executive Officer, President and Director

That's right, and keep in mind that the 6.9% rate increase in Cal Auto has not entered in at all. The MIC rate increase this quarter probably earned 25%, 30%. I expect about 75% earned in the third quarter and 100% in the fourth quarter for the MIC rate increase that went into effect in March.

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

Right. Gabe, I think you did say that most of the rate increases would be back-end loaded in the second half of the year, before.

Gabriel Tirador
Chief Executive Officer, President and Director

That's correct.

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

So I was listening to your brief comments, and you mentioned high single-digit severity. I don't have your transcript available from the first quarter, but I thought you said in the first quarter that it was mid-single digits. Has there been a change? Or am I making something up?

Gabriel Tirador
Chief Executive Officer, President and Director

No. I don't recall what we said, but definitely it's high single digits now. And if you take a look at the Fast Track trends in California, as an example, for the 12-month period ending March, severity for bodily injury increased 7.2% in California for BI. And pure premium, which is frequency and severity combined, increased about 10% -- 9.9% almost 10%. So we're definitely seeing it in the industry as well. Property damage liability, severity up for the 12-month period 6.3% for the industry with pure premium up 8.1%. On the collision side, you're seeing 3.8% severity increases in the industry with pure premium up 7%. So the industry is also seeing severity and some frequency increase here. So pure premium is up -- going up quite a bit in California.

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

Right. And just getting back to the $22 million of unfavorable development, if I recall correctly, in the first quarter, you said most of the $40 million in the first quarter allocated was allocated to 2014 year and then lesser amounts to years previous to that. And would I assume that the $22 million is the same in terms of allocation by accident?

Gabriel Tirador
Chief Executive Officer, President and Director

No, we increased our 2015 pick so that increased development about $10 million for the '15 year, company-wide. About $3 million went to '14 and about $4.5 million or so to '13 and '12. And what we're seeing -- our data showing is that we're -- the speed of closing on our older liability claims has increased. And we're also seeing some case reserve strengthening in our book of business. But while some of this increased case reserve and pay loss development was, undoubtedly, due to the speed up in settlements. When we take a look at one of our models, which neutralizes these changes, it basically said that we were still short. So we ended up increasing our estimates -- our ultimate estimates as a result.

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

Okay. So with a higher accident year loss pick for '15, I assume that's going to bleed over into your assumptions for '16 as well, correct?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, they have. They certainly have. And that's why, I mean, our '16 accident year, right now, when you take out, hopefully, there's no further development and you take out some of the noise, you're running at around $97 million in change, when you take that out. But that's correct, we have increased our picks for '16 as well.

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

yes, and so this is...

Gabriel Tirador
Chief Executive Officer, President and Director

It has a domino effect. When you increase an older accident year, and you increase the next one, the next one, the next one, it has a pretty big impact in the quarter on the calendar year results.

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

So just to wrap up, and then I'll requeue. As we think about your longer-term objective in terms of your combined ratio results, given where you've taken your accident year loss picks for '15 and '16, what should we be thinking about in terms of your ability to get a lower combined ratio, say, over the next 24 months?

Gabriel Tirador
Chief Executive Officer, President and Director

I think that's our #1 focus. And I tell you that's -- our combined ratio is going to improve. And our target is a 95% combined ratio, and the whole organization is focused on that right now. And over the course of the next 12 to 24 months, you're going to see a big improvement.

Operator

[Operator Instructions] I'm showing no further questions at this time, sir.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I'd like to thank everyone for joining us this morning, and we look forward to talking with you next quarter with better results. Thank you very much.

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