S&P Capital IQ

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Mercury General Corporation NYSE:MCY

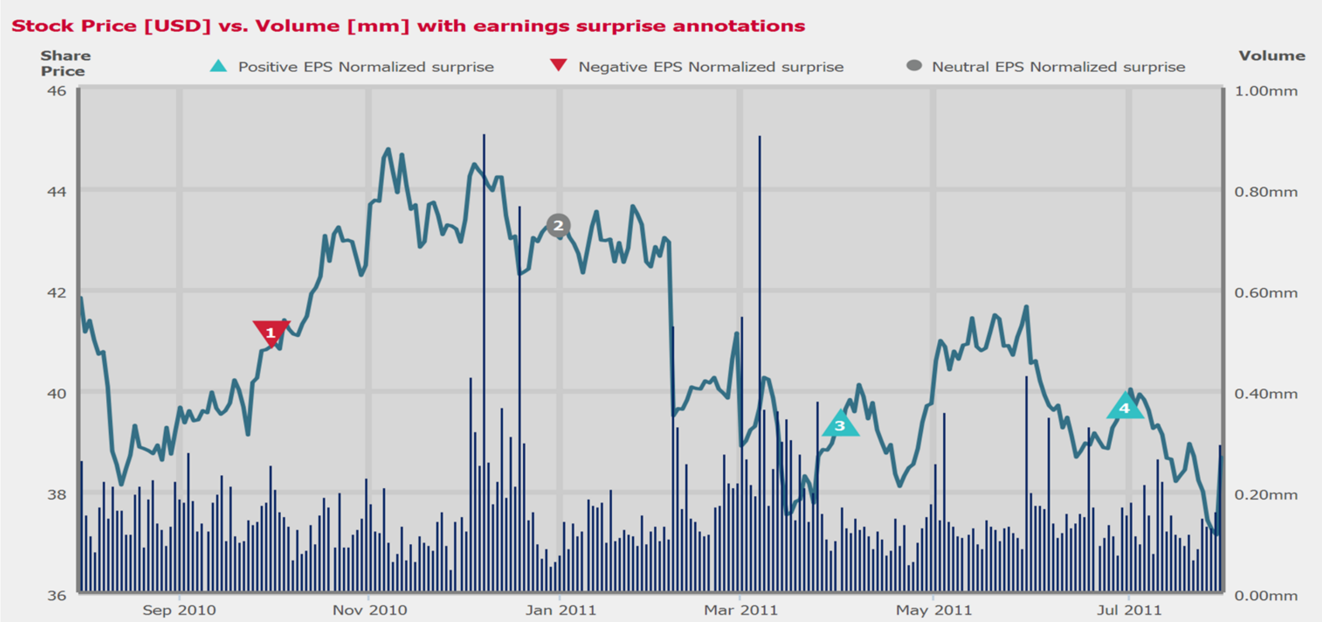
FQ3 2011 Earnings Call Transcripts

Monday, October 31, 2011 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2011-			-FQ4 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.69	0.72	4.35	0.69	2.87	2.73
Revenue (mm)	664.72	662.28	(0.37 %)	639.60	2618.04	2628.68

Currency: USD
Consensus as of Oct-31-2011 4:09 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2010	0.76	0.74	(2.63 %)
FQ4 2010	0.70	(0.15)	NM
FQ1 2011	0.53	0.72	35.85 %
FQ2 2011	0.62	0.76	22.58 %

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

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

Meyer Shields
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 Mercury General's third 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.

Thank you. I would now like to turn the conference over to Mr. Gabriel Tirador. Sir, you may begin.

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; John Sutton, Senior Vice President in Customer Service; and Robert Houlihan, Vice President and Chief Product Officer.

Before we take questions, we will make a few comments regarding the quarter. For the third consecutive quarter, our premiums written increased over the prior year. In the third quarter, premiums written grew by 1.2% and year-to-date, they increased by 1%. In addition, for the first time since the third quarter of 2007, California private passenger auto premiums written increased while the rate of increase in California was only 3/10 of 1%, it is a good sign to see California premiums return to the black.

California growth is benefiting from higher levels of new personal auto business sales as compared to prior year. Furthermore, our retention rates remain near historic highs. With a combined ratio of 98.3%, our operating results continue to be steady and we're aided by our continued focus on expense reduction. Lower profitability based aging commissions, lower spending on Information Technology and consulting, plus reduced advertising expenditures have lead to improvement in the expense ratio.

Year-to-date, we reported $11 million of unfavorable reserve development compared to $18 million of favorable development in the first 9 months of 2010. Excluding the impact from development, the loss ratio was 69.9% in the first 9 months of 2011, compared to 69% in the first 9 months of 2010. The third quarter and 9 months of 2011 were negatively impacted by losses from Hurricane Irene totaling $4 million on a pretax basis.

An automobile class plan we filed for our California companies has been improved by the Department of Insurance. The revenue neutral plan improves our segmentation and results in more refined pricing. The plan will be implemented in December and is expected to make the company more competitive in attracting new business but will cause some dislocation to our existing book of business.
Our Board of Directors approved an increase in our quarterly dividend to $0.61 per share, marking the 26th consecutive year that Mercury has increased our shareholder dividend. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Let me start on the investment portfolio. The duration have come down pretty sharply over the past couple of quarters and I'm wondering if you could give some guidance in terms of what we should expect from both yields and maybe the tax rate applicable to investment income?

Christopher Graves
Chief Investment Officer and Vice President

Meyer, this is Chris. Well, the duration has come down for 2 basic reasons: one is market related and the other is the fact that we've been buying bonds with shorter calls for a number of years now. So -- and we've purposely been trying to bring the duration back down from when it had a marked increase in 2008. So I think where it is now is actually a pretty good level. The month of October has been a little soft on munis so we've probably seen that duration move back out just a smidgen here during the month. Going forward, I mean, this is kind of where I'm targeting where I'd like it to be. So I'm pretty comfortable with it right here.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. So, that's helpful. Big picture, is there a significant difference between the targeted combined ration for auto and home?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, there is a difference between the targeted -- primarily because of catastrophes.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

So we should expect -- just looking at both accounts, the mix is shifting a little bit towards home. That should translate into a lower commodity ratio, if I'm reading it right?

Gabriel Tirador
Chief Executive Officer, President and Director

Absent any catastrophes.

Operator

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

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

You did mention a little bit of commentary with respect to expenses. And it seems the expense ratio showed some improvement this quarter. But I was wondering maybe if you could just give a little bit more detail on how the expense savings plans are going through and sort of what the progress you're making there has been. If you have any numbers to help out, that would be great.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Dean, this is Ted. We really started this year with tightening our expense control through tighter budgeting processes but we took some expenses out in the IT area, primarily in the consulting area. We refined our agent contingent commission calculations, which allow agents' profitability bonuses based on profit and growth. And let's see, where else? Advertising. We've got our advertising expenses down somewhat this year as well. I think it's hard to compare all of last year to this year because there were some onetime expenses last year related to Prop 17 [Proposition 17], which skewed last year upwards. But we're probably going to see expense ratios in the 27% to 28% range going forward.

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

Okay. So this quarter seems to be maybe a low watermark for -- may not be repeatable at the 27% flat, it could tick up a bit?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, we hope it's repeatable, but I won't say that we will repeat it.

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

Okay. Second question, I believe you had about $125 million of debt mature in August, and it looks like you've got another $120 million coming up early next year. Maybe could you give your sort of thoughts on -- are you going to be looking to replace that? On the capital side of the equation, how are we thinking about that now?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

The $125 million of senior notes was paid off on August 15. The $120 million, which was originally used to purchase AIS a couple of years ago, we have extended the maturity on that with the bank out 3 years and those will be maturing in 2015.

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

Okay, so no plans to add more after the recent August that it matured? No plans to kind of add any additional debt to the balance sheet structure?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We're not adding any new financial leverage right now.

Operator

The next question is a follow-up from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I was wondering if you could summarize, if it's even possible, the changes in the upcoming class plan. Is there a particular, I guess, subsegment that stands out as you get in the improvement?

Gabriel Tirador
Chief Executive Officer, President and Director

I'll let Robert Houlihan talk about that.

Robert Houlihan
Chief Product Officer and Vice President

Yes, with these changes we've introduced, a new proprietary symbol set and we've adjusted all of our relativities for all of our rating factors, so there's substantial number of changes. I don't think there was any one particular segment that sort of jumped out through that analysis.

Operator

Our next question comes from the line of Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Two questions. One, I was wondering if you could talk a little bit about the competitive environment in California maybe in a little more detail and then the second was on the reserve development. I don't know if there's anything else you can share but I guess it's been unfavorable now to some degree for 5 quarters. How you're looking at that? How you're building that into the pricing changes going forward and maybe, I don't know if you can share anything else, what you're thinking there?

Gabriel Tirador
Chief Executive Officer, President and Director

As far as the competitive environment, Alison, it continues to be a very competitive environment. As I mentioned in my prepared remarks, we were glad, very glad, to see positive premium growth for the third consecutive quarters. But the increase in advertising spend and the insurance base today as compared to, let's say 5 to 10 years ago, is pretty dramatic. So our goal has been for us to increase the number of folds being presented to potential customers and we believe that we have competitive rates but we need more looks. We also believe that our closing ratio can be improved upon with better segmentation. And the class plan that I mentioned earlier, that fine that we just are going to be implementing in December should help us with our new policy sales as well. Now I do think that, generally speaking, that you're going to start to see, I think more fines for some rate increases with lost cost going up in the future. And that's just my personal opinion. I think severity on BI is going to be higher than that it has been running but we'll have to wait and see for that.

Operator

[Operator Instructions] And there are no further questions.

Gabriel Tirador
Chief Executive Officer, President and Director

No further questions? Okay. Well, thank you very much for joining us today and we look forward to speaking with you next quarter.

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