S&P Capital IQ

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Mercury General Corporation NYSE:MCY

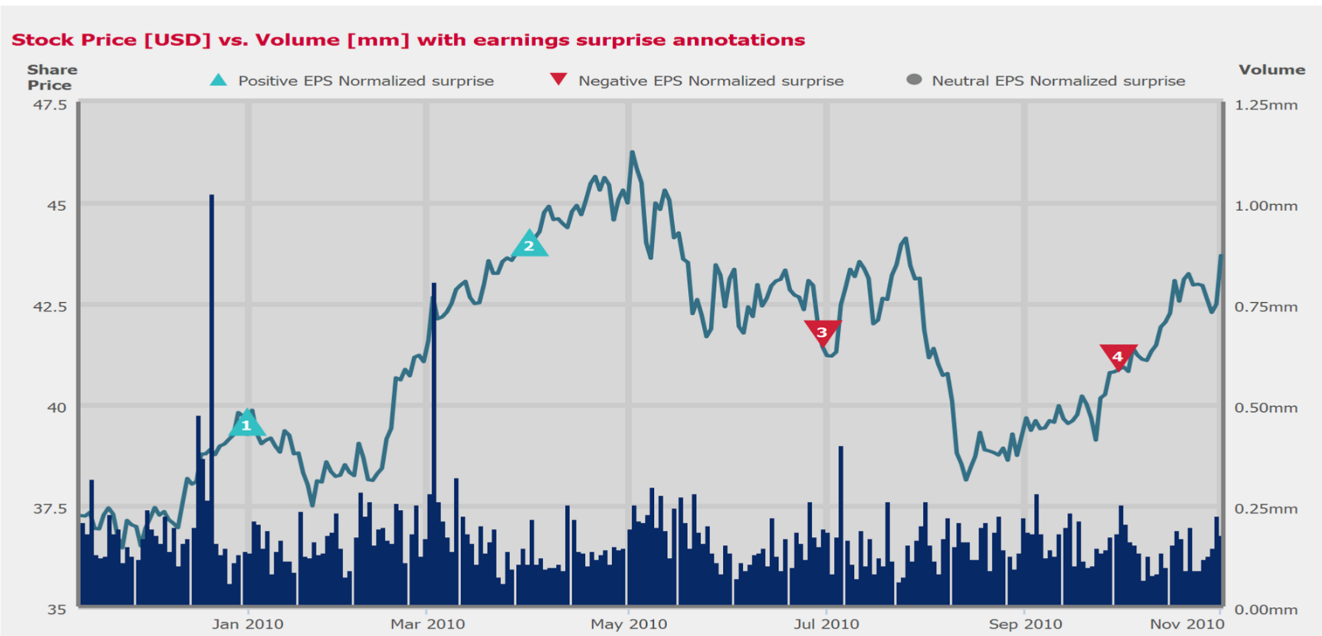
FQ4 2010 Earnings Call Transcripts

Monday, February 07, 2011 6:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.70	(0.15)	NM	0.72	2.96	2.10
Revenue (mm)	661.26	655.64	(0.85 %)	655.70	2688.04	2775.88

Currency: USD
Consensus as of Jan-24-2011 12:23 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	0.68	0.69	1.47 %
FQ1 2010	0.68	0.85	25.00 %
FQ2 2010	0.71	0.65	(8.45 %)
FQ3 2010	0.76	0.74	(2.63 %)

Call Participants

EXECUTIVES

Gabriel Tirador
Chief Executive Officer, President and Director

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Caroline Steers
Macquarie Research

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

Presentation

Operator

Good afternoon. My name is Wes, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Fourth 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 result 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 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 Chris Graves, Vice President and Chief Investment Officer.

Before we take questions, we will make a few comments regarding the quarter. Our fourth quarter 2010 operating results deteriorated significantly as compared to the fourth quarter of 2009. Our combined ratio was 109.9% in the fourth quarter of 2010 compared to 98.1% in the fourth quarter of 2009. Our fourth quarter 2010 operating results were negatively impacted by severe weather in California and sinkhole losses in our Florida homeowners line of business.

In California, severe rainstorms during the quarter impacted both our auto and homeowners results. In December, areas of Southern California experienced over 10 inches of rain during a five-day period from December 18 to December 22. As a result, our California auto frequency was up approximately 7% as compared to the fourth quarter of 2009. In our California homeowners line, we experienced an increase of over 1,500 claims in December 2010 as compared to December 2009. We estimate that the pretax losses resulting from the California rainstorms were approximately $25 million in the quarter.

Our Florida homeowners line continues to present significant challenges as a result of sinkhole claims. It produced a $19 million underwriting loss during the quarter. The underwriting loss includes the accrual of a premium deficiency reserve of $6 million. As reported, we are withdrawing from the Florida homeowners market and expect the withdrawal to be completed in the third quarter of 2012. In addition, to mitigate future losses until our withdrawal from this line is completed, we implemented a 25% rate increase in January and are modifying our claims practices with regard to sinkhole claims. In addition to the severe weather in California and our Florida homeowners sinkhole losses, October hailstorms in Arizona and winter storms in the Northeast states also negatively affected our results in the quarter.

We ended 2010 with $13 million of positive reserve development on prior year's reserves compared to $58 million in 2009. During the quarter, we recorded approximately $5 million of negative reserve development on prior accident years compared to $18 million of positive reserve development in the fourth quarter of 2009.

Last month, we implemented a new claim staffing model and made some changes to other administrative units. As a result of these changes, 160 positions were eliminated. The net annual savings from this change is approximately $11 million per year. We will record approximately $4 million in severance-related cost in the first quarter of 2011. In states outside of California, we continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. During the quarter, we implemented six rating changes in our auto line and one in our homeowners line. Currently, 12 private passenger auto rating changes and two homeowner rating changes are planned for the first quarter of

2011. The rate of decline in premiums written of 0.3% during the quarter was an improvement over the 3.5% rate of decline during the fourth quarter of 2009.
With that brief background, we will now take questions.

Question and Answer

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

One, I was wondering, we saw the dividend up to the parent company, and I was just wondering if you could share what the assets are at the parent company and the total amount of liquidity needed to be held there? And then I guess the second question, and I don't know how comfortable you'll be doing it if you can, if there's any way in the quarter to kind of maybe break out what total catastrophe losses were? I guess I'm trying to look at the Florida number. I assume that underwriting, that $19 million is after tax, the underwriting loss? If there's any way you can give what the total cat losses were in the quarter?

Gabriel Tirador
Chief Executive Officer, President and Director

Go ahead, Ted, talk about the dividends.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Okay. So Alison, the dividend up to the parent is really takes care all of our dividend needs for 2011. And our plan as we have some debt maturing in the parent company in August, $125 million, and so our plan is to repay that debt using a portion of the proceeds from this intercompany dividend. The remainder of this intercompany dividend will be used to fund shareholder dividend in 2011. The upstreaming of that $270 million will take place over the course of 2011, it won't all be in one payment. Does that answer that question?

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Yes. And just what are the -- is that the total assets at the parent? I mean, is there additional cash being held at the parent company level or invested assets?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

The parent company does have some cash and invested assets. I don't have the number off the top of my head. It's usually in the $40 million range, but I can get that number for you if you need it.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Okay. No, that's close enough. Thank you.

Gabriel Tirador
Chief Executive Officer, President and Director

And as far as the underwriting loss, it was a pretax number. The $19 million is a pretax number for the Florida homeowners sinkhole losses, and $25 million in the California storms that we estimate are also pretax numbers. So when you combine both of those numbers, it's about $44 million, Alison. We also, as I mentioned earlier in my comments, had about $5 million of negative development in the quarter. Even though for the whole year we ended up with $13 million of positive, during this quarter, we had $5 million of negative. The fourth quarter, irrespective of the catastrophes, the fourth quarter is always a weather quarter for us here in California, and usually the frequency goes up in the fourth quarter for us irrespective of these really monster claims that we had or the large number of claims that we had because of the

California storms that were so severe this quarter. But irrespective of that, it's always a higher frequency quarter for us.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Okay. So when we look at the Florida number that you said the $19 million was that total underwriting loss, so we're just going to associate all of that as being catastrophes?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. However you want to characterize it, that was the underwriting loss, and really it's all driven by sinkhole claims.

Operator

Your next question comes from Meyer Shields of Stifel, Nicolaus

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

With regard to Florida again, are there specific regions of Florida that are most susceptible to these sinkholes? I guess what I'm wondering is, why not just adjust rates where the sinkhole risk is more pronounced, if that even make sense?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, there are two areas that are more susceptible to sinkhole claims, and that is the Pasco and Hernando counties, kind of like the Tampa area counties. Although, we're starting to see some claims, not only us but the industry pop-up in other areas of the state. And so we thought that was the most prudent move for us to exit the line, the homeowners line. In addition to that, you obviously have the hurricane exposure in addition to the sinkhole claims. But there are two, primarily two counties in Florida with most of the sinkhole claims. But unfortunately, they're starting to pop up in other areas.

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

Okay. So just a risk aversion, if I can...

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

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

Okay. Could you quantify the Florida homeowners written premium for 2010?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, the written premium was $12.5 million.

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

And I'm hoping you could sort of take us through the GAAP accounting for the premium and deficiency reserve?

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

So the way that works is we evaluate our estimated future losses on the unearned premium that exists at year end. And to the extent that the estimated future losses on that unearned premium exceeds the unearned premium, then we record a reserve for that, and that was about $6 million at year end.

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

So going forward, to the extent that losses are incurred on this 12/31 unearned premium, that will still show up as incurred losses in the next couple of income statements?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That's correct. One point to note, the $6 million is actually recorded in the expense ratio, not in the losses.

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

And then that's not available to be amortized down so you'll have less expense ratio going forward?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Correct. Eventually, as the book runs off, that number will go to zero.

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

Do you have the accident year commodity ratio for California auto for 2010?

Gabriel Tirador
Chief Executive Officer, President and Director

We don't provide it. We do have it, but we're not providing that.

Operator

Your next question comes from Caroline Steers of Macquarie.

Caroline Steers
Macquarie Research

It looks like there was some adverse development this quarter. What years is that coming from?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That's primarily coming from -- it's coming from several years. It's generally coming from Florida and the sinkholes in and the auto '09, '08.

Caroline Steers
Macquarie Research

And then just on the duration of the portfolio, it looked down year-over-year, but versus last quarter, it went up a decent amount. And just wondering where you expect that to go going forward?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, the change in duration, of course, is more of a function of how it's calculated and the structure of our portfolio. We buy a lot of callable bonds in the past 18 months or so. We've been structuring a more or less defensive portfolio, buying bonds priced to their calls. In the month of November -- I mean, into the first few weeks of November, the curve was down about 50 basis points, and now it's out about 100. So those bonds in many cases that were defensive with very short durations are now being priced to their maturities. Now the curve is also very steep at this point, so having a longer duration may not be such a bad thing either at this point in time since we're at a historically steep yield curve. So we're going to continue, of course, to shorten duration and get it back down, but there's probably some upside potential there as we see the curve either flatten again or spreads tighten.

Caroline Steers
Macquarie Research

Okay. And then when you're reinvesting your money, do you continue to put them in municipal bonds?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I think there's market opportunities out there right now, so yes.

Caroline Steers
Macquarie Research

Outside California, where are you seeing the most opportunities. You're not expanding in Florida as much anymore. Is it the Northeast? Or are there other regions?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we're seeing growth in quite a few areas outside of California. Actually, our Florida auto line in 2010 over 2009 grew. We've seen some growth in the Northeast as well. We've seen some growth in our Georgia, our George auto line has seen some nice growth. Where we haven't seen as much growth have been in the Texas, in our Texas market, but we've made some recent changes there where we're now seeing a pickup there as well. So we're seeing a decent amount of business pickup on new business in many of the states outside of California.

Operator

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

Gabriel Tirador
Chief Executive Officer, President and Director

Okay. Well, thank you very much. I'd like to thank everyone for joining us in our fourth quarter conference call. We look forward to talking to you next quarter. Thank you.

Operator
And ladies and gentlemen, that concludes Mercury General's Fourth Quarter Conference Call. We appreciate your time. You may now disconnect.