

Mercury General Corporation NYSE:MCY

FQ2 2009 Earnings Call Transcripts

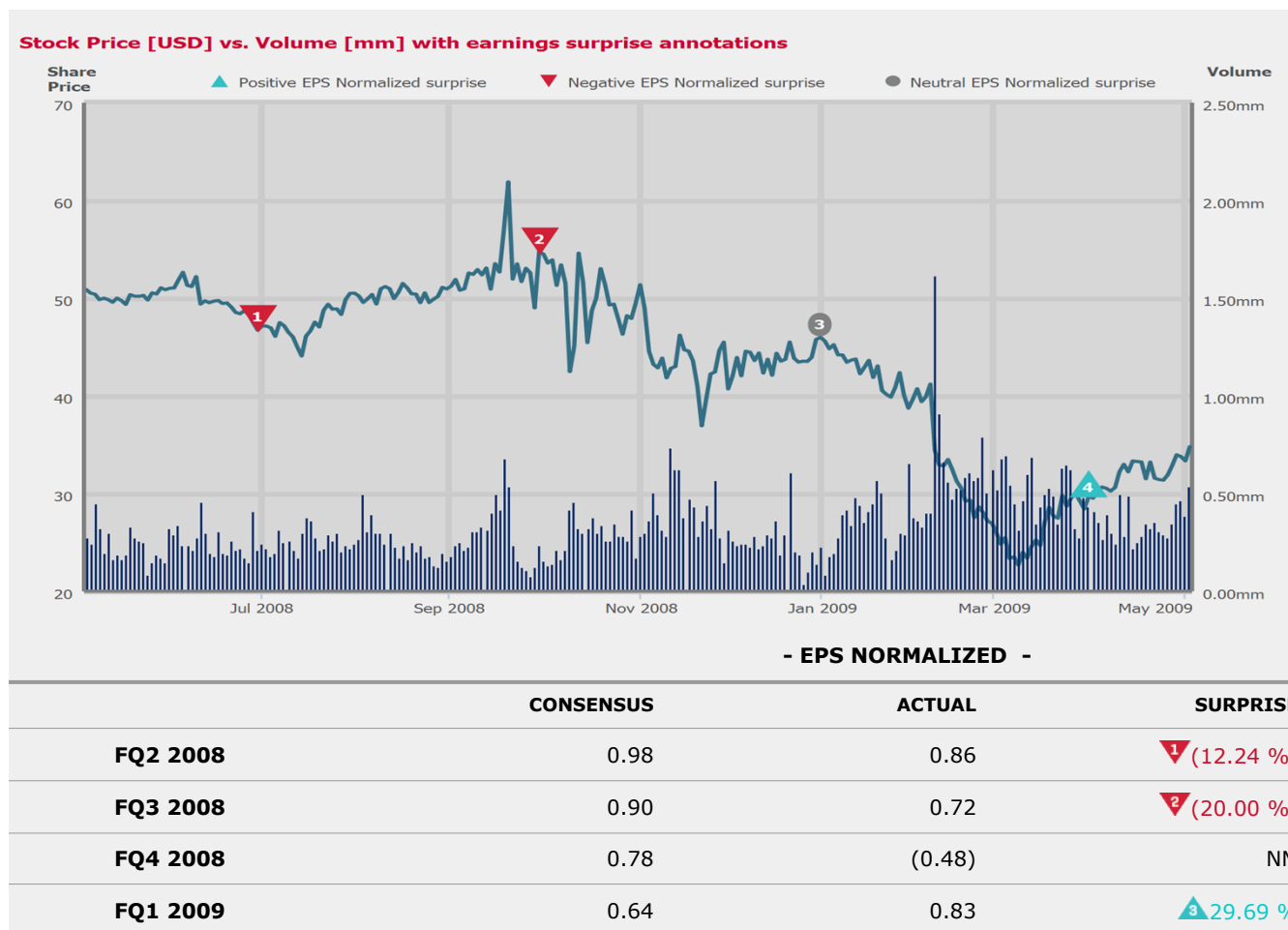
Monday, August 03, 2009 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.70	0.86	▲ 22.86	0.65	2.92	2.74
Revenue (mm)	629.60	637.40	▲ 1.24	643.00	2553.75	2492.35

Currency: USD

Consensus as of Aug-03-2009 4:41 PM GMT



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*

Daniel D. Farrell

*Fox-Pitt Kelton Cochran Caronia
Waller Limited, Research Division*

Joshua Shanker

Citigroup

Michael Wayne Phillips

*Stifel, Nicolaus & Company,
Incorporated, Research Division*

Presentation

Operator

Good afternoon. My name is Brandy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Second Quarter Earnings 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 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. 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 Ted Stalick, Vice President and Chief Financial Officer; Chris Graves, Vice President and Chief Investment Officer; John Sutton, Senior Vice President, Customer Service; and Robert Houlihan, Vice President and Chief Product Officer. On the phone we have George Joseph, Chairman; Bruce Norman, Senior Vice President of Marketing; and Ron Deep, Vice President of the South East Region.

Before we take questions, I will make a few comments regarding the quarter. I am pleased to report that our second quarter continued the theme of improving results as compared to the second half of 2008. Year over year, our combined ratio improved slightly from 97% in the second quarter of 2008 to 96.1% in the second quarter of 2009. The primary reason for the improved year-over-year results during the quarter was due to positive reserve development of \$31 million recorded in the second quarter of 2009 compared to \$9 million of adverse development recorded in the second quarter of 2008. Generally, we are recording increases in severity in the mid-single digits and reductions in frequency in the low-single digits.

We continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. During the quarter, we implemented a 7% rate increase in New Jersey and a 6.2% rate increase in Florida. The 7% rate increase in New Jersey was on top of a 5% increase earlier in the year. We introduced a new rating plan during the quarter in Georgia that has been well received and has resulted in an increase in new business applications in Georgia. In California, we have a pending auto rate filing with the Department of Insurance for a small rate increase. In addition, the filing introduces, among other things, new discounts and roadside assistance coverage. We plan on making additional improvements to our auto products and introduce new homeowner products over the next few quarters.

Premiums written declined 6.8% during the quarter to 637.4 million. The decline in premiums written was a slight improvement over the 8% decline in the first quarter of 2009. The competitive environment remains intense but we continue to observe more filings for rate increases than rate reductions as the industry-wide combined ratio for personal auto deteriorated to 100.4% in 2008 from 98.4% in 2007. We believe we will continue to see an increased level of rate action taken by some of our competitors. To improve our top line, we continue to focus on making product changes, improving our business processes and technology and providing superior customer service. Nevertheless, at this time, we expect our growth rate for the next quarter to be negative in the mid- to high-single digits.

Our new finance sales system, Mercury First, has been deployed to New York and Virginia. Both of these states have seen an increase in new business submissions, which we partly attribute to the new system. We have learned a great deal from the deployment of Mercury First to these states and are consequently making changes to the system prior to our next state deployment of Florida. We plan on piloting Florida within the next months or so with California to follow.

Lastly, you probably noticed we are no longer breaking out our results between California and non-California. We have done this primarily for competitive reasons and feel it is in the best interest of the

company and in alignment with our objective of becoming a national player. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Michael Phillips with Stifel Nicolaus.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

Gabe, I assume from the last comment about the information not being given, we shouldn't ask about premium growth by segment now on the conference call?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes. We're not going to be disclosing that. We're just going to be disclosing country-wide results. That's correct.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

On the reserve development last quarter, it was 21 million, and I think your comments were was mostly 2008 and mostly California, reasons were expected, better-than-expected late reported claims and better severity. Is that all the same basic for this quarter too?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes, Michael. It's almost exactly the same.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

And then you mentioned this better segmentation for quite a while. Can you say -- I guess is it New Jersey or New York or where would you say the states that you've gotten the most improvement in your segmentation so far?

Gabriel Tirador

Chief Executive Officer, President and Director

I'll go ahead and let Robert Houlihan, our Vice President and Chief Product Officer, answer that.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

And I mean if you could have him answer, what's states and kind of how long have these improvements been in place?

Robert Houlihan

Chief Product Officer and Vice President

The three states where we have improved tiering are New York, New Jersey and Georgia. New York and New Jersey both were effective in January, and Georgia was effective, I believe, in June of this year.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

You mentioned last quarter that expense savings from your 401(k) freeze, when does that end?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, it ends when we start doing our match again, which we haven't yet.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

So it's still about 5 million a year on annual savings and that any of the matches on place?

Gabriel Tirador

Chief Executive Officer, President and Director

Five to six.

Operator

Our next question is from Josh Shanker with Citi.

Joshua Shanker

Citigroup

I'd like to know what are your opinions on the proposed legislation for a national insurance regulation as opposed to you guys being mostly behold to California regulation?

Gabriel Tirador

Chief Executive Officer, President and Director

Our perspective is that a national regulation with one set of rules and standards for all the states that we do business would probably be a positive. As you know, Josh, we operate in 13 states today and we want to become a national player. And having different set of rules and regulations for both rates and forms is very cumbersome. Some states are easier to deal with than others. Our viewpoint is that if the right national regulation were to come into place that -- I think it would be overall, a positive.

Joshua Shanker

Citigroup

And in terms of the -- at this point right now, how do you find the regulatory environment in California?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, the regulatory environment in California is -- hasn't really changed much from what we can tell. We have a rate filing right now pending. It's been pending for quite some time but that's been somewhat typical, and one of the reasons that this last filing is taking so long is because of with the new rating factors that the department came out with last year, there was a lot of filings that came in to the department. But it's my understanding that recently, we've been providing more information to the department on some questions they've had. So they're actively working on our filing right now it appears. So at this point, I don't see any obstacles or any change I would say, any change in the regulatory environment in California.

Joshua Shanker

Citigroup

Is that a rate neutral filing or a rate increase filing?

Gabriel Tirador

Chief Executive Officer, President and Director

That has a very small rate increase. I think it's between 1% and 2%.

Operator

Your next question is from Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

On the expense ratio, absentee AIS, 3 million, was there anything else in there that was unusual? And I just wanted to double check that there's not going to be anything going forward that's unusual.

Gabriel Tirador

Chief Executive Officer, President and Director

No.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

And as far as the states that you're in, I was just wondering, we always hear about the ones that are in issue. If you could talk some about the ones that are going well, and where you're most comfortable of. I'm just kind of curious.

Gabriel Tirador

Chief Executive Officer, President and Director

Well, I guess it depends on how you currently define going well. I think that we've made quite a bit of improvement, from my standpoint, in some of the states where we've had some difficulty actually, New York, New Jersey being one of them. Some of the changes that Robert's group have made there, we have seen some app count growth, in addition to what we feel is improved profitability. But the states that -- we have quite a few states that are actually running below 100 though, if that's the question, and maybe two or three states, although those tend to be smaller states. Our goal is to continue to make some of the changes that we've been focused on segmentation and pricing. As Robert mentioned, really we've only had about a few of those states where we've introduced the full product, New York, New Jersey and Georgia being the three states. And we want to make sure that we continue with that strategy, and we're seeing a lot of good positive coming out of these product changes that we're doing.

Operator

Your next question is from Dan Farrell with Fox-Pitt Kelton.

Daniel D. Farrell

Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

I was just wondering if you can go into a little more detail on some of the movements in the reserves. And I guess particularly there were some further -- it looks like there was some further releases out of first quarter '09. And maybe if you could just talk about some of the drivers and as what you're seeing in the first quarter, if it then was driving some of the prior year development and then, it seems like large swings given a short period of time. So I just want to get your overall thoughts on that.

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

Typically, Dan, we experienced a certain amount of late reported claims, and they generally all come in a quarter or two after the accident period. And I don't know if it's the result of lower frequency or what, but definitely the level of late reported claims is coming in less than what it historically has been. So that's certainly one of the drivers. And also when we're looking at severity, we're constantly reevaluating that every period, and we've been taking that down somewhat, although as Gabe mentioned, we're still in the mid-single digits in what we're recording.

Gabriel Tirador

Chief Executive Officer, President and Director

The only thing I'll to add to that, Dan, is just so everyone understands, that \$31 million of positive reserve development this quarter included some re-estimation of the first quarter of this year. So it's not all prior year.

Daniel D. Farrell

Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

And then just broadly, can you talk a little about the investment portfolio? You have some uplift in the quarter but then, also some write-downs. Maybe just go into what some of the losses were, specifically if you can and just your overall view of the mini marketplace now.

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

Year-to-date, we've obviously had pretty good change in performance by both munis [municipalities] and common stock and through the year now, we've picked up a couple of hundred million in the portfolio. A good two-thirds of that comes from the muni bond. And you realize losses that we've taken this year has just simply been from assets being underwater from last year. We just felt that it was time to take those losses and move into something more productive.

Daniel D. Farrell

Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

The AIS amortization this quarter of 3 million, is that all of it going forward? Would there be any other unusual amortization?

Gabriel Tirador

Chief Executive Officer, President and Director

No, that's it.

Operator

Next question is from Michael Phillips with Stifel Nicolaus.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

Back on the auto side, would you expect, given the new systems in place in New York and New Jersey, I guess beginning this year, are you expecting positive growth overall for this year in those two states?

Gabriel Tirador

Chief Executive Officer, President and Director

In New York and New Jersey, positive growth in auto, not in New Jersey for whole year. No. I would say no. And in New York, some growth in New York.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

You got some nice growth in auto in some other random states. And I know it's a small base but it's still pretty good growth in Oklahoma, Pennsylvania. I haven't heard you mentioned those in terms of segmentation, but any thoughts on why those two states stand out as far as nice growth back in 2008?

Gabriel Tirador

Chief Executive Officer, President and Director

We've made some changes in Oklahoma, some minor modifications in Oklahoma although our new aligned product, which we've been talking about, doesn't go into effect -- when do we get that product in there, Robert, later this year?

Robert Houlihan

Chief Product Officer and Vice President

Oklahoma is scheduled for the third quarter.

Gabriel Tirador

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Chief Executive Officer, President and Director

It's scheduled for the third quarter, which is going to have more changes with improved segmentations. And in addition to that, in some of these states we've also introduced some payment plan offerings that have improved our app count as well.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

Any thoughts on Pennsylvania?

Robert Houlihan

Chief Product Officer and Vice President

Pennsylvania was the most recent state where we introduced our aligned product, and we actually have recently filed for a rate change after analyzing our initial results. So we're still very early in the process of evaluating that product rollout.

Michael Wayne Phillips

Stifel, Nicolaus & Company, Incorporated, Research Division

Your answer to previous question about the reserves, you said that it included some reestimation of the first quarter, did you mean favorable development for the first quarter or adverse development?

Gabriel Tirador

Chief Executive Officer, President and Director

It was favorable.

Operator

Our next question is from Josh Shanker with Citi.

Joshua Shanker

Citigroup

I just want to talk a little about duration, asset side versus liability side and whether using just in terms of the asset stand-alone, how you're considering duration in that portfolio?

Gabriel Tirador

Chief Executive Officer, President and Director

We're comfortable with the duration as it currently stands. I am shortening it up incrementally here, but with the outlook by the Fed on where things are, I feel okay with the rate of change that we're managing the duration at this point.

Joshua Shanker

Citigroup

Is there a target duration? You said you're shortening up. Are you moving towards the target?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes. We're certainly moving towards the target.

Joshua Shanker

Citigroup

Where would you like to be?

Gabriel Tirador

Chief Executive Officer, President and Director

We're probably going to get it under five years in the next 12 to 18 months.

Joshua Shanker

Citigroup

And incrementally, maybe about a tenth or a sixth of the year every quarter?

Gabriel Tirador

Chief Executive Officer, President and Director

I'm not really projecting it on any specific rate.

Operator

[Operator Instructions] Your next question is from Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

Are you willing to break out how much in the quarter was reserve development was true up for prior quarters and how much was this quarter? And I guess what I'm trying to get at is, what the accident year combined ratio is really running at on a quarterly basis this year?

Gabriel Tirador

Chief Executive Officer, President and Director

We gave you that. It's 100.8 for the accident year combined.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

Yes, but in the first quarter -- I guess if you're changing what would've happened in the first quarter, it would alter...

Gabriel Tirador

Chief Executive Officer, President and Director

That's in the 31 million.

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

Yes. That's included in that number.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

But how much of the 31 million was attributable to the first quarter?

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

Versus year-to-date?

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

Yes, versus prior year.

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

14.

Alison Marnie Jacobowitz

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BofA Merrill Lynch, Research Division

So of the 31 million, 14 million was for the first quarter?

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

Right.

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

And obviously, there was nothing for the second quarter?

Gabriel Tirador

Chief Executive Officer, President and Director

Right.

Operator

There no further questions at this time.

Gabriel Tirador

Chief Executive Officer, President and Director

Great. I'd like to thank everyone for joining us for the second quarter conference call, and we look forward to speaking with you next quarter. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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