S&P Capital IQ

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Mercury General Corporation NYSE:MCY

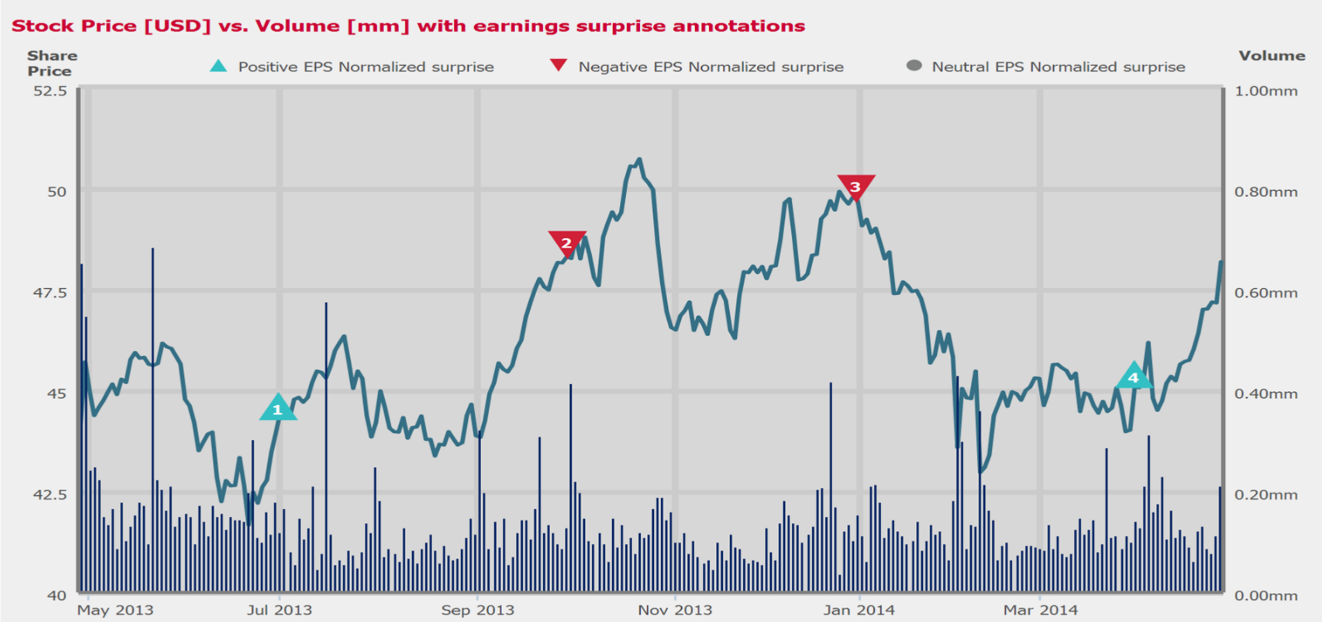
FQ2 2014 Earnings Call Transcripts

Monday, July 28, 2014 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.70	0.83	▲18.57	0.60	2.55	2.53
Revenue (mm)	688.77	698.76	▲1.45	729.57	2831.20	2994.92

Currency: USD
Consensus as of Jul-28-2014 1:32 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.61	0.63	▲1 3.28 %
FQ3 2013	0.64	0.53	▼2 (17.19 %)
FQ4 2013	0.53	0.33	▼3 (37.74 %)
FQ1 2014	0.61	0.77	▲4 26.23 %

Call Participants

EXECUTIVES

Gabriel Tirador
Chief Executive Officer, President and Director

ANALYSTS

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good afternoon. My name is Laurel, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Second Quarter Earnings 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, President and CEO. 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 second quarter conference call. I'm Gabe Tirador, President and CEO. In the room with me is Mr. George Joseph, Chairman; Robert Houlihan, Vice President and Chief Product Officer; and 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. Company-wide, we experienced our 14th consecutive quarter of positive premium growth. Premiums written grew 5% in the second quarter of 2014 and were driven primarily by higher average premiums from various rate increases in California. Premiums written outside of California declined 6.7% in the quarter.

Our second quarter operating earnings were $0.83 per share compared to $0.63 per share in the second quarter of 2013. The improvement in operating earnings was primarily due to improved results in our California private passenger auto business and lower levels of catastrophe losses, partially offset by worse results in our California homeowners business. Excluding the impact of catastrophes and reserve development, the combined ratio was 96.3% in the quarter compared to 96.8% in the second quarter of 2013.

Higher average California premiums aided the results this quarter. In our California nonstandard auto company, a 6.9% rate increase that went into effect in July of '13 is now being fully earned. In addition, a 6% rate increase in our California preferred auto company went into effect in January 2014 and had a significant positive impact on earned premium in the quarter. Slightly lower loss frequency in California also contributed to the positive results in the quarter, while our California private passenger auto severity increased in the low-single digits.

Although our California homeowners combined ratio deteriorated as compared to prior year, the combined ratio was under 100% in the quarter and improved as compared to the first quarter of 2014. Our California homeowners results this quarter were negatively impacted by a 5.5% rate decrease that went into effect in May of 2013. However, as we previously reported, we implemented an 8.25% rate increase in our California homeowners business in January 2014, which should continue to improve our results going forward.

Outside of California, our combined ratio, excluding catastrophe losses, deteriorated as compared to prior year, but was still under 100% for the quarter. We have taken various actions to improve our cost structure outside of California. Our pricing strategy is to price our products through expense targets that we have not yet achieved but expect to achieve over the next several years. Accordingly, our expectation is that our combined ratio outside of California for private passenger auto will run above our 95% target for the next several years. However, this pricing strategy will allow us to be more competitive than we otherwise would be.

With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Just to, I guess, start, just with a topic from last quarter. I think we talked about the drought providing a bit of a safer driving environment. I'm just curious if we should be thinking about a similar type of dynamic this quarter.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, actually, our frequency on a sequential basis in California was actually up a little bit in the second quarter compared to the first quarter. But when we compared it -- our frequency compared to the second quarter of '13, it was actually down slightly. So frequency was down year-over-year slightly. There was good weather in the quarter, so that contributed to the positive results, as well, our severity, as I mentioned earlier, going up in the low-single digits. We're also writing less new business in California, which comes at a -- new business comes at a higher frequency rate, so we're writing less of that, less new business. So that contributed to the results as well.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. As far as the new business impacting California, I'm imagining that's coming from the rate increases that are kind of earning through, both on the preferred and non-preferred books. And so just thinking about the rate strategy, I mean, my impression is, in California, as soon as you start to implement one, you should probably go back to the well. And so to your point on the new business impact, I'm just wondering if what you're putting through now gets you to a point of comfort in California or if you think that you would you be going back to the state to put a request in for another rate increase, if loss costs justify it.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we actually have filed for additional rate in both our companies. We have 6.9% rate increases that are pending with the California Department of Insurance for both our nonstandard and our preferred company. We think that the nonstandard company will more likely be approved sooner than the preferred company as that filing was implemented -- or we filed for that earlier than the preferred company.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, great. And then just switching over. I guess I would have expected to see the decision come through or at least the recommended decision from the ALJ get passed over to the commissioner. I was just going off the 60-day window from the 4/30 record close. But I mean, we're not too far off that by about a month, but I was just curious. Am I right in seeing that that's the delayed? And then if so, I was just curious if you have any thoughts on what the delay might be from.

Gabriel Tirador
Chief Executive Officer, President and Director

We don't know what the delay is from. The judge, I believe, should have rendered his decision 60 days after. Then 30 days after that, it becomes public. But for whatever reason, our understanding is that the judge has not yet rendered a decision, so we're just waiting at this point, Vincent.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, good to know. And then one last one, and then I'll let them somebody else have a shot. This is kind of a theoretical question, but if we look back to last quarter, you guys have taken your leverage up, and it was just ever so slightly. But thinking about the California regulatory environment and our discussion here on the rate increase dynamic and just thinking about it, if you can't quite hit the target returns that you want in California, from a rate standpoint, if that means that we should be thinking about maybe addressing that issue from a capital standpoint and whether or not maybe taking up your leverage a little bit more would make sense. And here, I guess, what I'm primarily thinking about is, if we pair that with your diversification plans outside of California, if you'd ever have any appetite to pursue an acquisition outside of California. So I'm just curious if that's a viable strategy or if it's just not really viable.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, with respect to the leverage, I mean, we feel comfortable where our leverage is right now. We had a 96% combined ratio. That got us to about a 9% return on capital, return on equity. A 95% will get us in the double digits. We feel fairly comfortable right now that we believe that, in California, we can reach our 95% target at least in the foreseeable future. Especially if we get these additional 2 6.9% rate increases, we will get there. We're there in our homeowners results. So as of now, I don't think that we have any plans with respect to any changes in our capital distribution or as far as buying back stock in any significant way or anything like that, Vincent. So we feel rather comfortable with the fact that, today, we feel that we could get to that 95% target in California that I believe will allow us to achieve a return on capital in the double-digit range.

Operator

[Operator Instructions] There are no further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Okay. Well, thank you for calling in, and we'll talk to you next quarter.

Operator
This concludes today's conference call. You may now disconnect.