S&P Capital IQ

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Mercury General Corporation NYSE:MCY

FQ2 2011 Earnings Call Transcripts

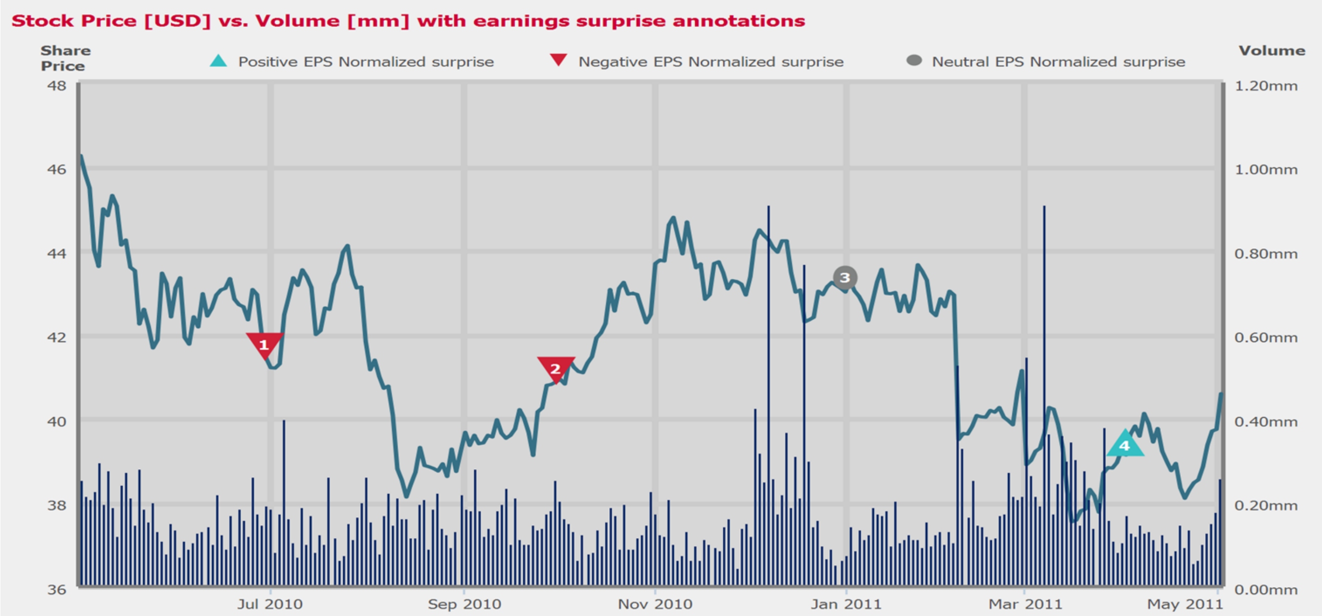
Monday, August 01, 2011 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.62	0.76	22.58	0.66	2.65	2.60
Revenue (mm)	648.19	636.29	(1.84 %)	665.18	2616.71	2626.01

Currency: USD

Consensus as of Aug-01-2011 1:13 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	0.71	0.65	1 (8.45 %)
FQ3 2010	0.76	0.74	2 (2.63 %)
FQ4 2010	0.70	(0.15)	NM
FQ1 2011	0.53	0.72	3 35.85 %

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

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

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

Unknown Analyst

Presentation

Operator

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.

Good afternoon my name is Brittany and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Second Quarter Conference Call. [Operator Instructions] Thank you. I would now like to turn the conference over to your host, Mr. Gabriel Tirador, CEO. 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 Second Quarter Conference Call. 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, Customer Service; and Robert Houlihan, Vice President and Chief Product Officer.

Before we take questions, we will make a few comments regarding the quarter. I am pleased to report that for the second consecutive quarter, premiums written increased over the prior year. Although premiums written increased by a modest 0.8% in the quarter, it marked the second consecutive quarter of positive premium growth since the first quarter of 2007. In addition, California product passenger auto new business sales during the quarter grew modestly on a year-over-year basis for the first time since 2006. Our operating results also improved on a sequential basis. The 98% second quarter combined ratio was slightly better than the 98.2% combined ratio posted in the first quarter of 2011.

The combined ratio was aided during the quarter by our continued focus in reducing expenses. In 2010, the expense ratio was negatively impacted by our support of Proposition 17. Excluding the cost associated with our support of Proposition 17 in 2010, our expense ratio declined from 28.7% in the second quarter of 2010 to 27.7% in the second quarter of 2011.

We were fortunate not to have been significantly impacted by severe weather in many states during the quarter that not only caused a significant amount of property loss but took the lives of some of our fellow citizens. Our catastrophe losses in the quarter were approximately $3 million, most of which was from the state of Georgia. Year-to-date, we recorded $10 million of unfavorable reserve development compared to $22 million of favorable development in the first half of 2010. Excluding the impact from development, the loss ratio was 69.3% in the first half of 2011 compared to 69.5% in the first half of 2010.

During the quarter, we sold our first policy online in the state of Georgia. Although early in the pilot, we are encouraged by the technology we have developed that allows for the sale of new business online and also includes our agency partners in the transaction. We will evaluate the Georgia pilot over the next several months and evaluate potential next steps, including the deployment of the online capabilities to other states.
As we mentioned in last quarter's conference call, we filed a class plan in our California companies to improve our segmentation. Based on our analysis, we believe there are significant opportunities to improve our segmentation. In other words, our current rating plan is overpricing and underpricing many risks. We have been working with the California Department of Insurance to finalize the filing. Since these class plans are revenue-neutral, we expect the approval process to be relatively smooth with an implementation date sometime later this year. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] And your first question does come from Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I was just wondering if you could talk a little about maybe more broadly for the seen [ph] severity trends and maybe margins inside California and out. And then also for the growth, if you could give a little bit more color maybe where that's coming from, what you're seeing there and your outlook for that in the quarters to come?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

On the loss side, Alison, this is Ted. In California, we saw a little bit of favorable trend in the second quarter, which might possibly be attributable to the high gas prices in the quarter. We're not positive but so I'm not sure if that's a trend or just some benefit we received in the second quarter. As we said before, outside of California, it varies a lot by state. In general, costs are going up but again, it varies a lot by state. Some are going down, several are going up.

Gabriel Tirador
Chief Executive Officer, President and Director

On the growth side, in California, Alison, we're relatively flat, maybe down slightly in California, offset by some growth outside of California, although it's a mix. There are some states outside of California that are growing more rapidly than others, and there are some states outside of California that are declining. So it is somewhat of a mix. Looking forward to this quarter, it's hard to anticipate what's going to happen in all 3 months but we are continuing to see at least in July in California the continued trend of new business sales being above where they were a year ago. So that trend has continued through July whether or not that continues for the remaining months in the quarter is yet to be seen. So that's kind of where we're at on the growth aspects.

Operator

Your next question comes from Meyer Shields with Stifel, Nicolaus.

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

Let me start. On the revenue side, the other revenue line picked up fairly dramatically again year-over-year. Can you talk a little bit of what's driving that?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, Meyer, this is Ted again. So our other income includes a lot of items such as gains on fixed asset sales, premium finance fees, changes in the market value of swaps not designated as hedges and commission income earned by AIS on policies written for other carriers. So there's a lot of different components in there. The increase this quarter was largely due to the gains on disposition of some older fixed assets that we liquidated during the quarter.

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

Okay. So if I understand it correctly, then we should assume that will come down to where it had been in the previous quarters?

Gabriel Tirador
Chief Executive Officer, President and Director

Could you repeat the question please?

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

I guess what I'm asking is the last, the prior 2 quarters was in the $3 million run rate. Is that a decent number for future quarters?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, that's more typical.

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

Okay. And can we just get, I guess, some discussion on your California muni holdings?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, we maintain a very low exposure to Cal geo debt. We've got on throughout the state the -- I'm sure I have our exposure right here in front of me but bear with me a minute here. Yes, it's about 11% of the municipal bond portfolio with an average rating of A+. I'm not sure what else you'd like to know about the...

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

No, just the 11% was what I was looking for. That's all.

Operator

[Operator Instructions] And your next question comes from Dean Evans of KBW.

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

I was wondering if we could get maybe a little more detail of the reserve additions in the quarter. It would -- it looks from the tax, it looks like it was largely from the 2010 accident year, I'm not sure if that's correct. Just any other color you have on that would be helpful.

Gabriel Tirador
Chief Executive Officer, President and Director

It's actually from the '09 accident year and a little bit from the '10 accident year in California. We did have some offset. We have some loss adjustment expense redundancies in some areas that partially offset that.

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

And is there anything, I guess, kind of major happening with the reserves? It seems like you had maybe 2 years there where you were seeing favorable development every quarter. Now for the last couple, 3 or 4 quarters, we've seen some minor additions. Anything changed in the overall reserving philosophy? Anything we should be thinking about from that perspective or is it just sort of, kind of what you mentioned, that the claims trends a little bit worse than expected?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We evaluate our reserves every quarter and do our best to make the most accurate estimate of what we think the losses will be. And as you know, it's an inexact science and sometimes we're a little over, sometimes we're a little under.

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

Okay. But nothing is really major changed in the way you look at it, no change in philosophy at all?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

No.

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

Okay. And I guess -- lastly, I guess, can you give us an update on how the Florida homeowners withdrawal is progressing?

Gabriel Tirador
Chief Executive Officer, President and Director

It's continuing to progress well. We started sending out the notices in March and policies are starting to non-renew in, I believe, September. And by September 2012, we should be out of the Florida homeowners market.

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

Okay. So the non-renewals don't start until September?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, because you're required in Florida to provide a 6 month notice and we started that 6 month notice, I believe, in early March.

Operator

[Operator Instructions] And your next question comes from Brian Perry [ph] of Sansone Partners [ph].

Unknown Analyst

It was in the papers last week that GEICO was forced to cut rates almost 11% in California and I was wondering if you could discuss the risks to your business in 2 regards. One, it's just a greater competitive threat from GEICO's lower prices? And 2, just the risk of greater advocacy from the regulators and consumer advocacy groups.

Gabriel Tirador
Chief Executive Officer, President and Director

Good question. With respect to GEICO, we run competitive analysis internally here among all of our major competitors and we still feel that with respect to GEICO that we still have very competitive rates today. So we still believe that our rates are very competitive. We also feel that with the new rate level that we anticipate putting into effects sometime later this year that I discussed in my prepared remarks that, that is going to actually be -- provide us with actually a more competitive rate on new business as well. So from that standpoint, we show -- fairly comfortable with our competitive position in the marketplace right now. Your second part of the question, regarding regulatory actions from either the interveners or the DOI itself, it's something that we have had to deal with, really, for the past I don't know how many years, many years. And it's something that not only us but the whole industry has to deal with. And I believe GEICO had originally filed for a small increase and ended up refiling it for a small decrease in the neighborhood of lower single digits but ended up with a negative 11, that's my recollection. At least, that's my recollection. But we deal with it. We feel that we when make a rate filing for an increase, which we actually anticipate making a rate filing for an increase here in California shortly, I would say probably by the end of September, we will make a rate filing for a small increase here in California. We feel that we can substantiate our rates.

Unknown Analyst

Okay, so it's -- I mean it's pretty remarkable for one company to file for a slight increase and end up with a massive decrease but it sounds like you're saying, "Hey, that's a GEICO-specific problem." That may be something specific to the way they were calculating the rate increase that was appropriate

Gabriel Tirador
Chief Executive Officer, President and Director

I can say that in our latest filing that we filed back in December, we had filed for a small increase and ended up with a decrease but the spread between -- the spread that we had was not as broad as the spread that GEICO had. I mean, they had come up with a plus something and had a negative 11. Our spread was not nearly that wide. In our last filing that we had back in December, where we had filed for, I think, a 1.5 and ended up with a negative 4, those are ballpark figures.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I know you mentioned the expense ratio in your openings remarks but I just want to make sure I'm not missing anything. So was there anything unusual that helped it? How do you see the run rate there going forward?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Probably the year-to-date run rate is pretty close to where we see it going. We are a little under 28 for the quarter. There's not a lot of unusual items in there but we have done a really good job this year of reining in expenses. We've reduced our technology spend. Our ad spend is a little lower this year than it's been in previous years. And we're just watching the expense closely.

Operator

And we have no further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Okay. Well, I would like to thank everyone for joining us this quarter, and we look forward to speaking with all of you next quarter. Thank you.

Operator
And this does conclude today's conference call. You may now disconnect.