S&P Capital IQ

CONTENTS

Mercury General Corporation NYSE:MCY

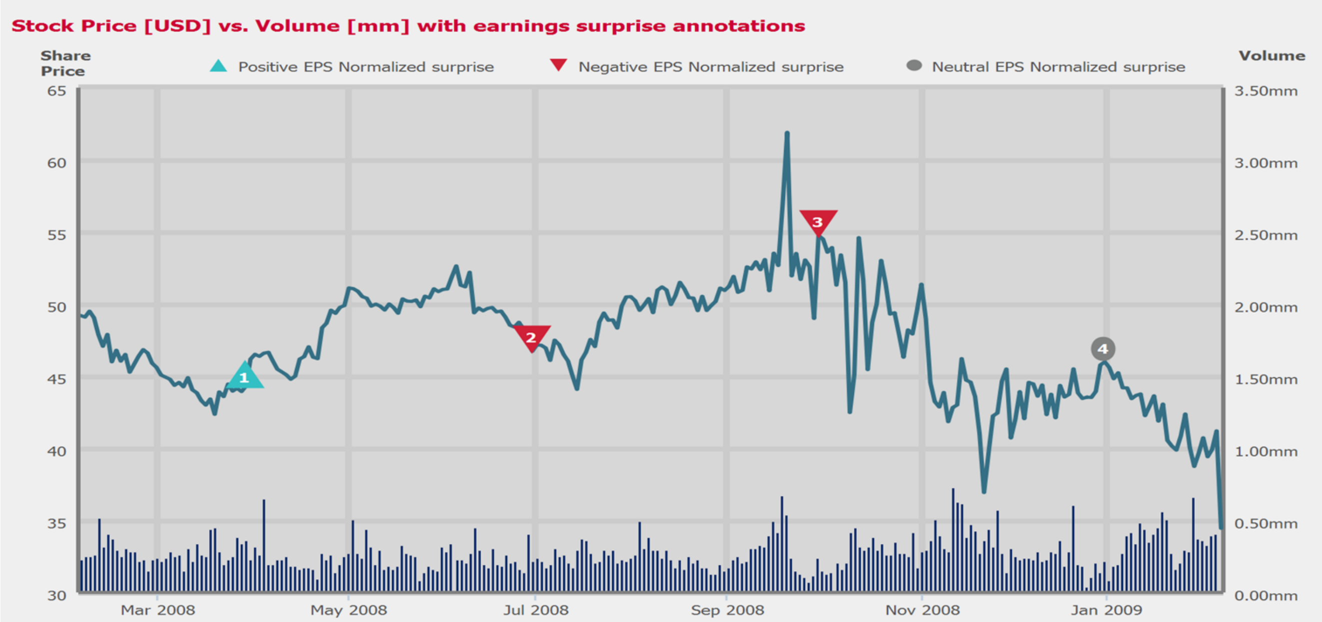
FQ1 2009 Earnings Call Transcripts

Monday, May 04, 2009 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.64	0.83	▲29.69	0.71	2.80	2.81
Revenue (mm)	697.80	670.89	▼(3.86 %)	630.20	2643.45	2611.00

Currency: USD
Consensus as of May-04-2009 4:07 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	1.00	1.02	▲1 0.99 %
FQ2 2008	0.98	0.86	▼2 (12.24 %)
FQ3 2008	0.90	0.72	▼3 (20.00 %)
FQ4 2008	0.78	(0.48)	NM

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

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

Daniel D. Farrell
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

Joshua David Shanker
Citigroup Inc, Research Division

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Unknown Speaker

Presentation

Operator

Good afternoon, my name is Celeste [ph] and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General First Quarter Results Conference Call. [Operator Instructions] This conference call may contain comments and forward-looking statements based on current plans, expectations, events in 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. Please go ahead, sir.

Gabriel Tirador
Chief Executive Officer, President and Director

Thank you very much. I would like to welcome everyone to Mercury's First 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, Chief Investment Officer; and John Sutton, Senior Vice President of Customer Service. On the phone we have Bruce Norman, Senior Vice President of Marketing and Ron Deep, Vice President of the South East Region.

Before we take questions, we will make a few comments regarding the quarter. I'm glad to report that our result in the first quarter improved significantly over our very disappointing fourth quarter 2008 results. Our combined ratio improved from 113.4% in the fourth quarter of 2008 to 96.9% in the first quarter of 2009. Year-over-year, our combined ratio increased slightly from 95.4% in the first quarter of 2008 to 96.9% in the first quarter of 2009.

In our California operations, our combined ratio increased slightly from 94.1% in the first quarter of '08 to 94.2% in the first quarter of 2009. Although the combined ratio was about the same as prior year, the California loss ratio was 3.3 points lower than prior year and the expense ratio was 3.4 points higher. The lower California loss ratio was primarily driven by approximately 18 million of positive reserved development compared to 5 million of adverse reserved development in 2008, and lower frequency recorded in the mid-single digits. This was partially offset by $5 million in severance costs related to a reduction in force of approximately 7% of our workforce in March 2009, higher severity recorded in the mid-single digits, and the impact on earned premium from our California rate reduction in our personal auto line taken in the second quarter of 2008.

We attribute the improved year-over-year reduction in frequency to more favorable weather conditions as compared to prior year and reduced driving as a result of the current economic environment. The increase in severity is primarily related to the bodily injury coverage. The higher California expense ratio was primarily attributable to $3 million in severance related cost and the $12 million charge related to the accounting treatment of deferred acquisition costs related to our AIS acquisition.

As disclosed in our press release, we expect this charge to be $3 million in the second quarter of 2009 with no material impact thereafter. Excluding these two items, the California expense ratio was 27.3% compared to 26.7% in the first quarter of 2008. Our combined ratio of 106.5% in our non-California operations was a significant improvement over 128.8% combined ratio posted in the fourth quarter of 2008. As we have previously reported, our non-California results are primarily driven by Florida and New Jersey.

In Florida, we have a 6% rate increase that we're going to effect later this month and in New Jersey, we implemented a 5% increase in January 2009 and have recently filed for an additional 7% rate increase. In addition to Florida and New Jersey, we experienced severe weather in Georgia and Oklahoma during the quarter which negatively impacted our non-California results.

The competitive environment remains intense. Growth continues to be a challenge in the current environment. However, we have seen some positive results from our recent changes in New Jersey and New York. In both of these states, although we increased our overall rate level, we experienced an increase in new business submissions as a result of improved segmentation in these states. We continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. We implemented two personal auto rate changes and introduced a new homeowners product in Arizona during the first quarter of 2009 and expect to implement three personal auto changes and introduce homeowners in one state during the second quarter.

In California, we have a rate pending with the California Department of Insurance to increase our overall rates by about 2%. In addition, this filing introduces a few new discounts that we believe, will make us more competitive on new business. We are also evaluating, making some process related changes that we believe will increase new business submissions from our agency force, as well as introducing new marketing related programs. As expected, the earnings from our acquisition of auto insurance specialist on January 1, 2009, were slightly accretive to earnings during the quarter after amortization of intangible assets and debt service cost.

Now, before we take your questions, Ted Stalick, our Chief Financial Officer will comment on our capital position.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Thanks, Gabe. During the quarter, shareholders equity grew by 4% to 1.56 billion primarily as the result of increased market values on our bond portfolio. Statutory surplus remained at approximately 1.4 billion, as the increase in bond values did not materially impact statutory surplus. As you know, bonds are accounted for an amortized cost per statutory accounting purposes and market values under GAAP accounting. Our capitalization is very strong and our leverage is conservative. The premiums to surplus ratio remains at 2:1, our debt to total capital is 15%, up since year end as a result of 120 million in financing related to the AIS acquisition. Our liquidity is good with cash and short-term investments of $273 million at March 31, 2009, compared to $240 million at December 31, 2008.
We believe that maintaining a consistent dividend makes Mercury an attractive investment. When establishing dividends, we have a preference for steady or increasing dividends. Every quarter, we also evaluate our current capital position, our operating results and our future expectations. If possible, we prefer to take a long-term view and provide a consistent dividend regardless of what happens with short-term results. Our strong capitalization has allowed us to maintain our dividend during a period when many companies were cutting their dividends. And with that, we'll open it up for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Michael Phillips with Stifel, Nicolaus.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Let me start with a reserve question. How much is it? Can you break it down by accident year, how much of that specifically with accident year 2008?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

The vast majority of it was 2008.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Of the favorable development, correct?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

And am I correct that one time you took -- before this, you've taken about $30 million for 2008 by the end of the calendar year, is that correct?

Gabriel Tirador
Chief Executive Officer, President and Director

For what? The whole company or what?

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes, so you're saying the majority of the 20 million was accident year 2008?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That we took in the first quarter of '09?

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Right, that's correct.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

And the second was, I believe you had taken some favorable developments on accident year '08 at the end calendar year '08?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We had adverse development.

Gabriel Tirador
Chief Executive Officer, President and Director

At 408 at '08, you really don't take any prior development because it would be '07.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

No, I'm talking at the end of calendar '08, you had taken some on the previous accident year '08 in the first three quarters?

Gabriel Tirador
Chief Executive Officer, President and Director

I see what you're saying. On a quarter basis not on accident year basis?

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Correct. It's still accident year '08 to the first three quarters of that.

Gabriel Tirador
Chief Executive Officer, President and Director

I think in the fourth quarter, Michael, actually if I recall right, most of the development was on prior accident years not on quarters within '08.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

What are your thoughts on, I guess it's kind of two parts here, on the competitive environment in California, I guess from specifically because of the news with the Larkin and the direct competition there from the direct channel and I guess especially now that, that's part of an exchange where it looks like, all in that could be too quick to create a more competitive environment these days. It's taken 21st century...

Gabriel Tirador
Chief Executive Officer, President and Director

We've always competed very well with 21st century over the years, over the past 40 plus years. We expect to continue to be able to compete with them well. Having said that, as I've mentioned in my prepared remarks, the competitive environment is very intense, there's a significant number of players that continue to advertise heavily in this market. The margins are still pretty good in this market so it's been a difficult environment in which to draw. From our standpoint, what we have seen is that our retention levels have been relatively flat to slightly up actually, which has been that our new business submissions have dropped off to a level such that it's not quite enough to replace what we're losing despite the fact that our retention levels have remained relatively stable, that could be a factor. Couple of factors, one is, as I've mentioned in the competitive environment but in addition to that in this current economic environment, we do believe that the number of uninsured motors is probably going up. So it's probably a combination of those two factors.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

It kind of relates to that, it sounds like this isn't the case but just to confirm, you talked about pushing some more rate increases throughout event on [ph]non-California. Are you sensing any push back at all for rate increases given the economic environment and maybe the fact that some of these economic environment obviously create in less driving and so the trends are better, most trends are better than what most people thought, say, a year ago. So maybe the need for rate increases isn't much there plus there's maybe some, I guess, where a push back too. Do you see any of that?

Gabriel Tirador
Chief Executive Officer, President and Director

We haven't seen any push back really, from our recent finds in New York and New Jersey. Although, I will tell, you it's a long process. They ask a lot of questions and we go back and forth many times not just on the overall rate level, but also on specific questions relating to class plan type of questions. But we really haven't had, at this point, any type of significant push backs from any of the regulators at this point. They take a look at our own data and although as you mentioned the frequency is down, we are seeing an increase in severity especially in the bodily injury area.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

The non-California expense ratio, I know you talked about the freezing salaries and such, tax and expense ratio but how sustainable is that something in the 30, 30.5 range with non-California going forward?

Gabriel Tirador
Chief Executive Officer, President and Director

I think we're going to see it between our goal. Obviously, it's for it to be under 30 but we'll probably see it in the 30 to 32 range if I had to do a forecast now going forward.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

What was that goal they mentioned? Is that like a five-year long-term goal?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That's a corporate objective.

Gabriel Tirador
Chief Executive Officer, President and Director

Part of the challenge obviously is when you have declining top line in certain fixed cost. It does put pressure on the expense ratio but as I mentioned earlier, we're doing various things to try to increase our top line. And outside of California, we actually increased rates in two states and saw an increase in new business submission because we improved segmentation. Those are the types of things that we need to continue to do in all of our states and we're also taking a look at some marketing related programs that hopefully will help spur some new business.

Operator

[Operator Instructions] I'm going to bring Michael Phillips back on with Stifel, Nicolaus.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

First, Mercury, can you talk about how that's coming along in the deployment of that in different states?

Gabriel Tirador
Chief Executive Officer, President and Director

We have that deployed currently in two states, New York and Virginia, and next is going to be Florida and thereafter California, I believe, is the schedule. We anticipate having most of our states up by the end of the year but unfortunately, it is going to trickle out to 2010.

Operator

Our next question comes from the line of Tom Morowitz [ph] with Crowell, Weedon.

Unknown Speaker

Dramatic improvements in the bond and equity markets even after the close of the quarter, couple of questions, this might be for Chris. Has anything changed in terms of investment strategy? And also a second question, what would it take for the consideration of the dividend increase before year end?

Christopher Graves
Chief Investment Officer and Vice President

On Investments first, no changes on investment strategy. We are trying to bring the duration down from this year but we're not going to get too aggressive yet. And then equity exposures, we are trying to find the stocks that are still paying dividends, that universe has shrunk quite a lot this year, but investment income from the entire portfolio is still important to us.

Gabriel Tirador
Chief Executive Officer, President and Director

On the dividend side, the Board decides that under quarterly basis and we take a look at a lot of factors including our current capital position or dividend payout ratio and the future prospects. So it's hard to evaluate whether or not increasing the dividend at this point is something that we're going to be doing because we take a lot of factors into consideration when we decide that. But as Ted mentioned in his prepared remarks, we can tell you that the company's objective is to have steady or increasing dividends.

Operator

Your next question comes from the line of Alison Jacobowitz with Bank of America-Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Most of my questions have been answered but I don't think I heard more on the expense savings that you've done. I guess I was curious if you could talk about some manner and if you can get that's fine, but what areas you're targeting for reductions and what you might be looking at going forward?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We actually have pretty much taken the bulk of the expense savings in March. We had a reduction in force which we believe is going to yield about a $20 million annual savings beginning in the second quarter. We put a temporary hold on our 401(k) match beginning April 1st which is about $5 million savings annualized going forward. We've done some other things, smaller things, which we think will yield some benefits too. We don't have any plans to do any additional, major cost cutting at this point.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I'm just curious, have you ever done such a similar workforce reduction? This is the first right?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

No.

Operator

[Operator Instructions] Our next question comes from the line of Wesley Gilaig [ph] with Wesley Gilaig [ph].

Unknown Speaker

I'm curious about -- if you could just outline the factors behind the positive development for the 2008 year sort of about like in the first quarter $21 million. The second question relates to what sort of circumstances do you feel would be necessary to begin growing again in terms of premiums written?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I'll answer the reserved question, Wes. Really, for California which was 18 million of the 21 million, two things. The amount of weight reported claims was lower than we originally expected and our estimates or severity in '08 ended up being a little higher than we initially estimated at year end. We brought those down a little bit.

Gabriel Tirador
Chief Executive Officer, President and Director

I guess one of the biggest keys for us to begin growing again in the future is, and I mentioned it a little bit in my prepared remarks, is better segmentation. We need to do a better job in segmenting our pricing and we have definitely done that and are doing that in some of our states that I mentioned earlier. In New York and New Jersey, we actually increased rates but improved our segmentation and we saw some growth. We're also taking a look at some better discounts where here in California that I mentioned earlier that we think -- again, it goes back to segmentation at the end of the day even though in California, you have some restrictions, better segmentation. A second thing is eventually, adding states. Eventually we'd like to add additional states to our portfolio where obviously would help to grow if we're adding geographic expansion. So those are some of the things that we're looking at. It wouldn't hurt if rates were going up more rapidly, I think, as well if the market begins to turn from a pricing standpoint. And we have seen at west where, – and it varies a little bit by state, but companies starting to take some rate increases. Now, this current trends on frequency have been favorable not only for us but for the industry as well. But we do see that the severity, especially in the bodily injury line, continue to go up. So we're very closely watching the rate fillings from our competitors. And the last thing I would mention is expanding into new areas, new products such as motorcycles, other new products that we're contemplating adding.

Unknown Speaker

Good. The experience in New York and New Jersey sounds very positive.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

Operator

Our next question comes from the line of Joshua Shanker with Citi.

Joshua David Shanker
Citigroup Inc, Research Division

Considering the five-year plan, so to speak, we have drivers amount that's going into the direct sales base and I'm wondering in your planning, looking at what share of the market do you think will be agency directed in maybe a three-year outlook or five-year outlook and what does that mean for Mercury in their long-term planning?

Gabriel Tirador
Chief Executive Officer, President and Director

Well first, that's hard to predict. I believe the right channel right now probably has a market share of 11, 12%, something in that neighborhood. But we've recognize the fact, Josh, that the times have changed and people do go on the Internet and either want to buy or do their research on Internet. So we are looking at how we could leverage the Internet more effectively and including the agents in the process. It's something that we are keenly aware of and are evaluating as far as what we do going forward with respect to those buyers that tend to, whether buy online or over the phone. And those tend, in our view, tend to be more of the younger generation. We do find that, as the another generation decide to get married, have some kids, they now own a home that perhaps that channel is not the ultimate best channel for them. But again, we do recognize that it's something that is ongoing today and it represents not a small piece of the whole pie, so it's something that we want to try to leverage.

Joshua David Shanker
Citigroup Inc, Research Division

Do you have any thoughts whether you lose a customer, whether they're going to a number of agency carrier, or whether they're switching direct?

Gabriel Tirador
Chief Executive Officer, President and Director

Do we have any thoughts on that, you're saying?

Joshua David Shanker
Citigroup Inc, Research Division

Yes.

Gabriel Tirador
Chief Executive Officer, President and Director

We do studies so we get reports on as best as we can, when someone needs where they go. And it varies, here in California for example, ironically, very few go to GEICO from what we can tell from our customers.

Joshua David Shanker
Citigroup Inc, Research Division

In 21st century?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

Joshua David Shanker
Citigroup Inc, Research Division

That's the bigger share of your population?

Gabriel Tirador
Chief Executive Officer, President and Director

I'm sorry, say that again?

Joshua David Shanker
Citigroup Inc, Research Division

21st century, do you find that they're going there?

Gabriel Tirador
Chief Executive Officer, President and Director

No. Yes, as the same as GEICO.

Operator

Our next question comes from the line of Dan Farrel with FPK.

Daniel D. Farrell
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

Just one quick question on the non- California operations, I think you said that there were a couple of states that have some higher weather-related type losses, if I'm not mistaken. Can you quantify about how much of impact that may have had on a combined ratio results in the non- California ops?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, we had mentioned that Oklahoma and Georgia specifically. And year-over-year, if you compare them to last year, add about $3 million.

Daniel D. Farrell
Fox-Pitt Kelton Cochran Caronia Waller Limited, Research Division

I understand you've been repricing some of that non-California that you'd been facing in segment and pricing. What's your ultimate target to try and get for a combined ratio for that business, and how long do you think it will take to achieve that to save that pricing in eventually?

Gabriel Tirador
Chief Executive Officer, President and Director

Our target is 95% excluding, I would say, operations that are relatively new because those will tend to take longer to get there because of the efficiencies. But how long it would take us to get there? It's going to vary by state, we're not going to get there in 2009. I would like to think that we get there in 2010.

Operator

[Operator Instructions] And we have a follow-up question from the line of Michael Phillips with Stifel Nicolaus.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Given the use of the development in it's most actual rate [ph], can you say what the current court laws for close [ph] just in expense ratio is for that year, actually in '08 now, compared to what the current is for '07?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I don't have that handy. I can get it for you though.

Michael Wayne Phillips
Stifel, Nicolaus & Company, Incorporated, Research Division

Alright, I'll call you after.

Operator

And we have no further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

I'd like to thank everyone for joining us and we'll talk to you again in about a quarter. Thank you.

Operator
This concludes today's Mercury General First Quarter Results Conference Call. You may now disconnect.