S&P Capital IQ

CONTENTS

Mercury General Corporation NYSE:MCY

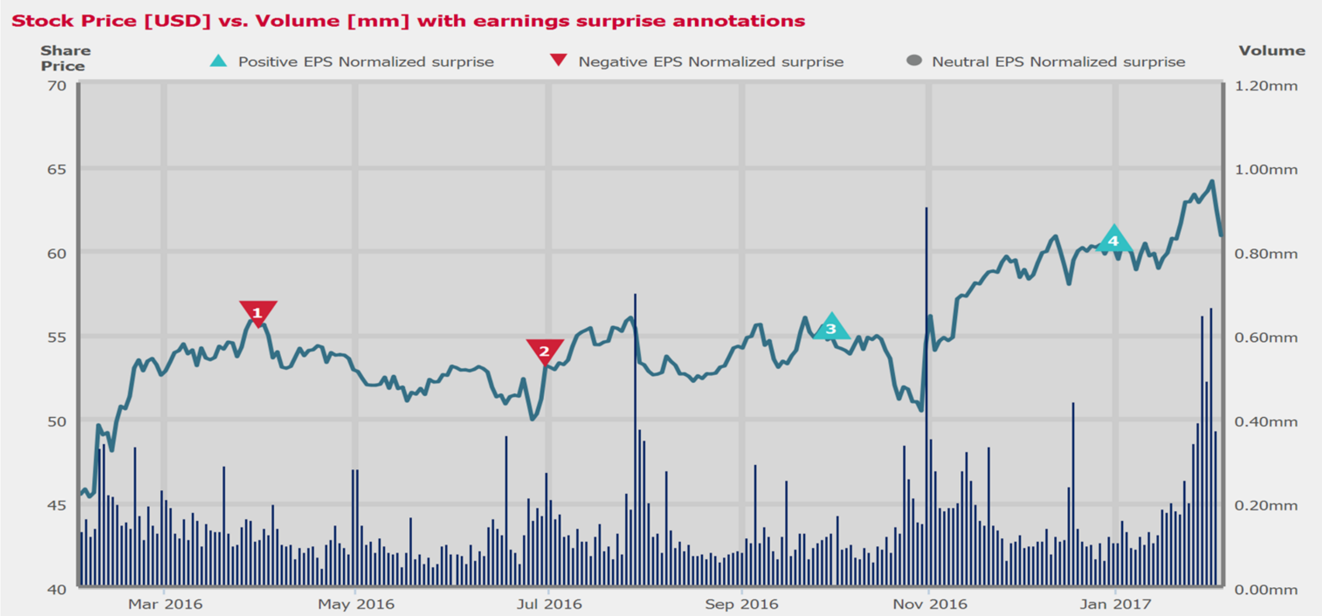
FQ1 2017 Earnings Call Transcripts

Monday, May 01, 2017 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.20	(63.64 %)	0.60	2.45	2.78
Revenue (mm)	829.68	811.59	(2.18 %)	815.85	3289.10	3419.79

Currency: USD
Consensus as of Apr-14-2017 10:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	0.68	0.13	(80.88 %)
FQ2 2016	0.59	0.35	(40.68 %)
FQ3 2016	0.54	0.67	24.07 %
FQ4 2016	0.51	0.58	13.73 %

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

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

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Gary Kent Ransom
Dowling & Partners Securities, LLC

Presentation

Operator

Good morning. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General First 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 results 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 first quarter conference call. I'm Gabe Tirador, President and CEO. In the room with me is Mr. George Joseph, Chairman; Ted Stalick, Senior 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 first quarter operating earnings were $0.20 per share compared to $0.13 per share in the first quarter of 2016. The improvement in operating earnings was primarily due to an improvement in the combined ratio from 103.9% in the first quarter of 2016 to 103.1% in the first quarter of 2017.

Our results in the quarter were negatively impacted by $30 million of catastrophe losses and $4 million of unfavorable reserve development, the majority of which was attributable to higher-than-estimated development of property losses from storms in December 2016. This compares to the first quarter of 2016, which had $8 million of catastrophe losses and $40 million of adverse reserve development.

Rainstorms in California accounted for $23 million of the $30 million of catastrophe losses in the quarter. Storms in Georgia and Texas made up the majority of the remainder of the catastrophe losses in the quarter. Excluding the impact of catastrophe losses and unfavorable reserve development, the combined ratio was 98.8% in the quarter.

Our homeowners results were significantly impacted by the record rainfall in California during the quarter. Our calendar year homeowners combined ratio was 129.6% in the quarter compared to 99.8% in the first quarter of 2016. Our calendar year auto combined ratio was 98.5% in the quarter compared to 105% in the first quarter of 2016.

To help offset increasing loss trends, we have been increasing rates. In California, we received approval for a 6.9% personal auto rate increase in California Automobile Insurance Company effective in May and a 6.9% rate increase in our homeowners line effective in August. In addition, a 5% rate increase is pending approval with the Department of Insurance for Mercury Insurance Company.

Personal auto premiums in Mercury Insurance Company represents about half of our company-wide premiums earned, and California Automobile Insurance Company represents about 14% of our company-wide premiums earned. California homeowners premiums represent about 11% of our company-wide premiums earned.

Premiums written grew 1.7% in the quarter, primarily due to higher average premiums per policy. Company-wide private passenger auto new business applications submitted to the company decreased approximately 16% in the quarter as we focused on improving profitability in our private passenger auto line. Company-wide homeowners applications increased about 2% in the quarter.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Greg Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I had just a couple of questions. First of all, like you have in the past quarterly calls, I was wondering if you could give us an update on frequency and severity trends in the first quarter, not only as they relate to the year-ago comparison but also as it relates to the fourth quarter result.

Gabriel Tirador
Chief Executive Officer, President and Director

Ted, do you want to handle that?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, the overall frequency was obviously elevated due to the cat losses, but when you strip out the cat losses, the trends vary a lot by state. We tried to sort of focus on California because that's our largest state. So California personal auto, frequency's up slightly in the quarter, and we're seeing severity increases in the mid- to upper single digits, so pure premium kind of the mid-upper single digits. I think the latest Fast Track had annual pure premium of about 10% for California. And that's reasonably comparable to the trend we've been seeing for the last few quarters.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

So if we look back on the result for auto insurers, just auto only in California, I have to imagine last year, most of them didn't do too well. And consequently, I'm wondering how the Department of Insurance is responding to the rate increases because they must be getting many of them.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, they've been getting many of them, and from what we can tell, many are getting increases, including us, so the department has been approving rate increases. We've been seeing that in the marketplace. And I will note that in this quarter, our private passenger auto results actually were in California, we booked a 97.2% combined ratio in the quarter with pretty heavy weather, as Ted was mentioning. So we feel that with a 6.9% rate increase that we got coming here in Cal Auto, that's going to continue to improve the results we have of 5% pending that will probably come later in the year, and we have a 6.9% in our homeowners book that we got approved that is going to go into effect in August. So obviously, the heavy rains in California definitely had a very big impact on our homeowners line this quarter.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Right. And if I look at just the consolidated net premium written in the first quarter, it was -- relative to what I thought it might be -- look like, it came in below target, at least my expectations, and with all the rate that's going through, I'm curious if there's some other non-Florida -- non-California states that are affecting the consolidated growth of that to come in less than 2%.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, outside of California is definitely having a much bigger impact than California. If you take a look at our new business volume this quarter, our app counts for California, they were down 3% -- 3.4%, but outside of California, they were down like 38%, and that is a result of us just taking aggressive action in some of these states outside of California to improve the combined ratio, which we are seeing quite a bit of an improvement in the combined ratio in some of these states outside of California as a result. But it's obviously having an impact on our top line. In our case, and I think we said at the end of last quarter, at the end of the fourth quarter, we basically told everyone that we thought that the growth was going to be relatively flat, we felt, in 2017.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay, all right. Just 2 clean-up questions. In -- first of all, I did notice that you had a higher quarterly interest expense in the first quarter compared with the fourth quarter and all of last year. I'm just curious if the first quarter result is expected to continue through the remainder of the year.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

So we refinanced all of our short-term bank loans, and we closed that transaction at the early part of March with a 10-year senior debt offering. And the short-term loans were a spread over LIBOR, so we're being priced off of short-term rates. We were in the process of renegotiating that debt. Rates were going to go up due to higher spreads required by the bank as well as LIBOR rates have been going up as well. So we thought that we would lock in some long-term rates over a 10-year period with these senior notes. And because of that, you are going to see higher interest expense. It's fairly easy to calculate now. It's 4.4% times $375 million of outstanding debt.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Excellent. And then I'd be remiss if I didn't lob a question in Chris' direction on investment income. The result, obviously, improved on a year-over-year basis, taking away just the realized gains, just looking at the quarter. And I was a little bit surprised the trends of last year relative to 2015 were down low to mid-single digits. Have we crossed the threshold where now it's reasonable to assume that you're going to begin growing investment income again?

Christopher Graves
Chief Investment Officer and Vice President

Yes, Greg. Last year was one of those periods where there was -- we're kind of at a pivot point. And where rates started the year, it certainly was at a rate or at a level that would be accretive, but we've -- rates have come back down. So I'm kind of tempering my excitement for the year, but I think that we'll definitely grow income over last year. But I do have an internal goal, and I think it may be challenging, but I think we may still get there. So I'm cautiously optimistic.

Gabriel Tirador
Chief Executive Officer, President and Director

I mean, I think the after-tax yield this quarter was the same, if I -- 3.1, is that right, Ted? So the after-tax yield has stabilized, and it had been declining for, as you know, Greg, for some time now. But this latest quarter compared to the quarter in 2016, the average annual yield on investments after income tax was steady at 3.1. We're hopeful that, that stays at that level or possibly higher, depending on what interest rates do. We do expect, at some point, to -- for interest rates to rise. They backed up here a while ago, but now, they've come back down a little bit, so we'll have to wait and see what happens with the interest rates.

Operator

[Operator Instructions] The next question is from Gary Ransom from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I wanted to ask about your agent force, whether when you watch what's happening in the agent offices, whether the quote volume you're seeing is up, or do you see more shopping? And are you winning more of those quotes, losing more of those quotes? I just wonder if you could give us a little color of what's happening at that level.

Gabriel Tirador
Chief Executive Officer, President and Director

Do you want to talk about that, Robert?

Robert Houlihan
Chief Product Officer and Vice President

Yes. This is Robert Houlihan. It varies from state to state. I think we're -- we've taken rate maybe in advance of the market in a number of these states, so we've seen our conversion rate generally lower, but we're again cautiously optimistic as the market catches up, and we're seeing other carriers taking rate action that will move back to more normal levels. Quote volume, I think, has been fairly steady, fairly even. I don't think we've seen a big uptick in shopping at this point.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. Yes. On the California regulatory environment, too, is that -- it always seems to take a long time to get your approvals through. And are you already in process to file another one for Cal Auto, knowing that it may take several months to get it through?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we just got it approved.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Yes, I know. That's sort of my point. It's like everyone asks 6.9%, and then that may be keeping up with trend, but maybe you need more. And...

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, and what I was going to say is like what we did in MIC is we just got MIC approved not too long ago. And right after we got that approved, we -- a few months later, we filed for a 5%. So we're going to evaluate basically this quarter. We do quarterly indications, and based on that quarterly indication, we'll make an evaluation. But it -- let me just put it this way, it would not surprise me if we filed, within the next 90 days another rate increase in Cal Auto.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Do you feel like you're able to put through the price increases quickly enough to stay up with loss cost or in fact, get ahead of loss cost to improve the loss ratio there?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think if loss costs don’t continue to go up at these high rates that we've seen, absolutely. I mean, as I mentioned earlier, our combined ratio in California was a 97% -- 97.2% this quarter with a lot of weather. So -- and we still have the 6.9% that's going to be coming into effect for Cal Auto, and we got the MIC one coming on the heels of that hopefully later this year. So if trend continues at 10% a year, then we're going to -- 8% to 10% a year, then we're just going to hold steady, right? But at some point, we don't think that trend's going to continue at these elevated levels, and you'll see the combined ratio go down even further.

Operator

There are no further questions. I will turn the call back over to the presenters.

Gabriel Tirador
Chief Executive Officer, President and Director

We'd like to thank everyone for joining us this quarter. We look forward to speaking with you again next quarter. Thank you very much.

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