S&P Capital IQ

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Mercury General Corporation NYSE:MCY

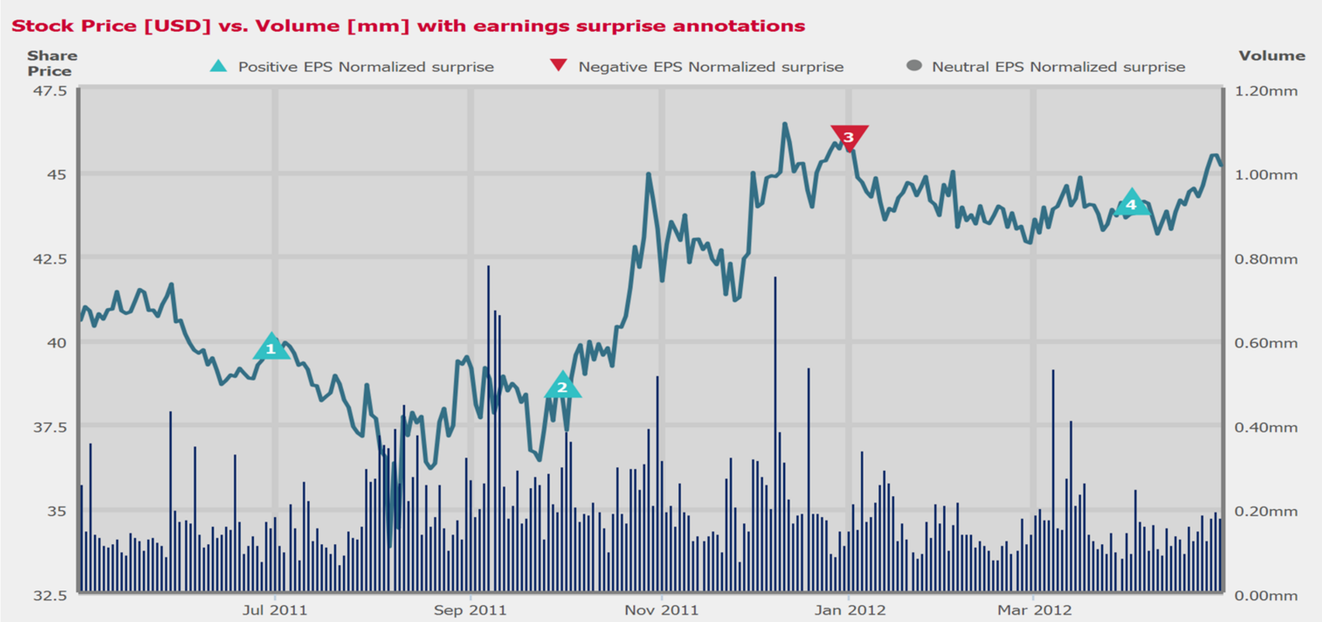
FQ2 2012 Earnings Call Transcripts

Monday, July 30, 2012 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2012-			-FQ3 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.19	(71.64 %)	0.66	2.62	2.67
Revenue (mm)	638.84	653.63	2.32	665.60	2585.00	2611.55

Currency: USD
Consensus as of Jul-30-2012 2:33 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	0.62	0.76	22.58 %
FQ3 2011	0.69	0.72	4.35 %
FQ4 2011	0.69	0.59	(14.49 %)
FQ1 2012	0.69	0.71	2.90 %

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

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

Raymond Iardella
Macquarie Research

Ronald David Bobman
Capital Returns Management, LLC

Presentation

Operator

Good morning. My name is Regina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Corporation Second Quarter 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 could not 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 second 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, 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. Our second quarter results were negatively impacted by unfavorable reserve development, severe weather outside of California and a general increase in severity trends.

Our combined ratio was 104.5% in the second quarter of 2012 compared to 98% in the second quarter of 2011. We recorded $23 million of unfavorable reserve development on prior-accident years in the quarter and $29 million for the first half of 2012. Most of the development came from California's bodily injury coverage. Law suits for the most recent accident years for California bodily injury developed at a rate quite a bit higher than historical averages.

Accordingly, we thought it was prudent to weigh the more recent trends more heavily and increase our estimate for future loss development. This had the effect of increasing our severity kegs [ph] for the most recent accident years.

Outside of California, catastrophe losses were approximately $8 million in the quarter, primarily the result of severe Midwestern storms. Excluding the impact of reserve development and catastrophe losses, the combined ratio was 99.6% in the second quarter of 2012 and 98.2% for the first 6 months of 2012.

In California, we have a 6% private passenger auto rate increase pending with the California Department of Insurance. We expect to have final resolution of the pending auto rate filing within the next month or so. Our hearing on our California homeowner rate filing has concluded, and we expect the decision from the administrative law judge in the next few months.

Our combined ratio was aided during the quarter by our continued focus on reducing expenses. Consequently, our expense ratio declined to 26.5% from 27.7% in the second quarter of 2011. On a more positive note, premiums written increased for the sixth consecutive quarter. The growth was 2.7%, the highest it has been since we started growing in 2011.

Our running neutral California rating plan we implemented in December of 2011 caused dislocation to some of our existing customers but improved our competitive position for new business. Consequently, our California new business private passenger auto sales increased year-over-year in the quarter by 17%.

In addition, the company began writing annual policies in our largest California personal auto company. The number of annual policies written was approximately 4% of the total California auto policies written. A portion of the company's written premium increase is attributable to the introduction of annual policies.

However, we estimate that was mostly offset by the temporary decline in retention from the dislocation caused by the rating plans we implemented in December of 2011.

The rate dislocation caused our renewal rates to decrease but at a rate lower than we had expected. After-tax investment income declined by 12% to $28 million in the quarter. As we mentioned last quarter, going forward, it will become increasingly difficult to maintain the current after-tax yields as bonds with higher coupons mature or are called, and the reinvestment of those proceeds will most likely be made at lower after-tax yields. The after-tax yield in the quarter was 3.7% compared to 4.3% in the second quarter of 2011.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Our first question will come from the line of Ray Iardella with Macquarie.

Raymond Iardella
Macquarie Research

Just a couple of quick questions and then I'll get back in the queue. I guess, first, I guess you talked about the new business trends in California from the rate plan in December. I mean, do you guys expect that to continue in the third quarter or we have we kind of gone through a complete cycle of new business?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, our expectation right now, if you take a look at what's happened in July, it's continued. The new business has continued to be strong in July. It's hard to say what may happen August and going forward, but what I can tell you is that July was a relatively strong month for new business.

Raymond Iardella
Macquarie Research

Okay, that's fair enough. And then I guess thinking about the pending rate change in California. And I know you guys had mentioned plus 6% and kind of expecting decision the next month or so. How quickly can you guys implement that into your policyholders?

Gabriel Tirador
Chief Executive Officer, President and Director

I'll let Robert Houlihan answer that.

Robert Houlihan
Chief Product Officer and Vice President

Well, we can implement from an IT perspective fairly quickly. We do need to send renewal notices in advance to customers so the process usually takes a couple of months primarily because of the requirement to notify renewal customers.

Gabriel Tirador
Chief Executive Officer, President and Director

So probably about 60 days once we get approval, something like that.

Raymond Iardella
Macquarie Research

Okay, so it's probably a fourth quarter event just trying to put a timeframe around it when you could actually pass these rate increases onto the policyholders.

Gabriel Tirador
Chief Executive Officer, President and Director

That's probably reasonable.

Raymond Iardella
Macquarie Research

Okay. And then last quickly, update on the Florida homeowners business. Are you guys still on track to get out in September?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes, we are on track.

Operator

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

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

Gabe, you mentioned that you're going to be incorporating higher, more recent severity trends in your results. Does that explain why the loss ratio excluding catastrophes and development went to 73% or so just under 70% last quarter? Is that a good run rate going forward?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, Meyer, it's Ted. We're seeing severity went from low single digits to now we're estimating mid single digits, and that's definitely increasing pressure on the loss ratio.

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

Okay. Was there any impact to your continued commission bookings in this quarter from the adverse development or maybe from the catastrophes as well?

Gabriel Tirador
Chief Executive Officer, President and Director

We did adjust some profitability-related accruals. So you'll see our expense ratio was about 26.5%. We expect the run rate is going to be closer to 27%.

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

And, that's helpful. One last one if I can. Does the shift -- obviously, policies are growing faster on the homeowners side. Does that have any implications for, I guess, your target premium to surplus ratio?

Gabriel Tirador
Chief Executive Officer, President and Director

Could you restate the question?

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

Yes, I'm sorry. It appears based on the data in the press release that you're growing policies much more rapidly on the homeowners side than on the auto side. Because homeowners is a little bit more volatile, does that mean that there's going to be more of a capital demand, which would limit the premium to surplus ratio [indiscernible]?

Gabriel Tirador
Chief Executive Officer, President and Director

I mean, generally speaking, you are correct that the homeowners line requires more capital. But I think, we're writing right now 1.8, something like that to 1. So we feel that we have more than ample capital to continue to grow our business both in the homeowner and the auto line.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I guess, 2 questions. I don't know if you can give more color on the severity trends and just maybe talk some about you're seeing, is it an industry trend? Or how do you feel about what's happening there and what's driving the change? And then if you could talk about the regions outside of California in total and how underwriting is going there? Maybe give us an update.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, as far as the severity trends, I think that other carriers are showing that they're seeing severity trends going up as well. I think I saw Progressive and Travelers talk about severity trends going up, Fast Track indicates that severity trends are going up. So this is, I think, is an industry trend, not just a Mercury-specific trend. As far as our regions outside of California, we continue to make improvements with our pricing and our segmentation outside of California. This quarter, Alison, we were hit very hard. We had some -- there were catastrophes in the Midwest. We booked about $8 million of cat losses there that hurt us. And in addition to that, it was just a bad quarter outside of California with respect to loss because I think the weather even outside cats was not that favorable this quarter. So -- but we continue to make aggressive changes outside of California in our rates. And then most of the states outside of California, we're able to get rate. So we're feeling better about what we're doing out there outside of California, and so that's basically it.

Operator

[Operator Instructions] Your next question will come from the line of Ray Iardella with Macquarie.

Raymond Iardella
Macquarie Research

Just a question on the development. Any favorable offsets in the business outside of California? I'm sorry if you guys mentioned that, but I might have missed it.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Not really. There are some modest favorable development in a couple of states but nothing significant that would offset the unfavorable.

Gabriel Tirador
Chief Executive Officer, President and Director

The numbers we report, just so everyone's clear, is the net number, obviously.

Raymond Iardella
Macquarie Research

Yes. Yes. And just one other quick question. As far as the accident loss ratio. I think year-to-date, about a 71.5% roughly is kind of what I'm calculating. Is that the right way to think about what you guys are selecting going forward for the business? All else equal, if nothing changes today?

Gabriel Tirador
Chief Executive Officer, President and Director

No. I mean, I think on a year-to-date basis, what did I say? I think that we had a combined at a 98.2% combined ratio.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes.

Gabriel Tirador
Chief Executive Officer, President and Director

I tend to look at year-to-date results. A quarter can fluctuate. So that implies like a 71.5, something like that.

Operator

[Operator Instructions] Our next question will come from the line of Ron Bobman with Capital Returns.

Ronald David Bobman
Capital Returns Management, LLC

I have a question about your cats. I was wondering which particular cats the company suffered from this month, sort of what geographies?

Gabriel Tirador
Chief Executive Officer, President and Director

It was primarily Midwestern storms, Oklahoma, Texas, Georgia, hail, some tornadoes. It was multiple events.

Operator

And at this time, there are no further questions. I would turn the conference back over to management.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we'd like to thank everyone for joining us this quarter, and we hope to give you some better news next quarter. Thank you very much.

Operator
Ladies and gentlemen, this does conclude today's conference. Thank you, all, for joining and you may now disconnect.