S&P Capital IQ

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Mercury General Corporation NYSE:MCY

FQ4 2009 Earnings Call Transcripts

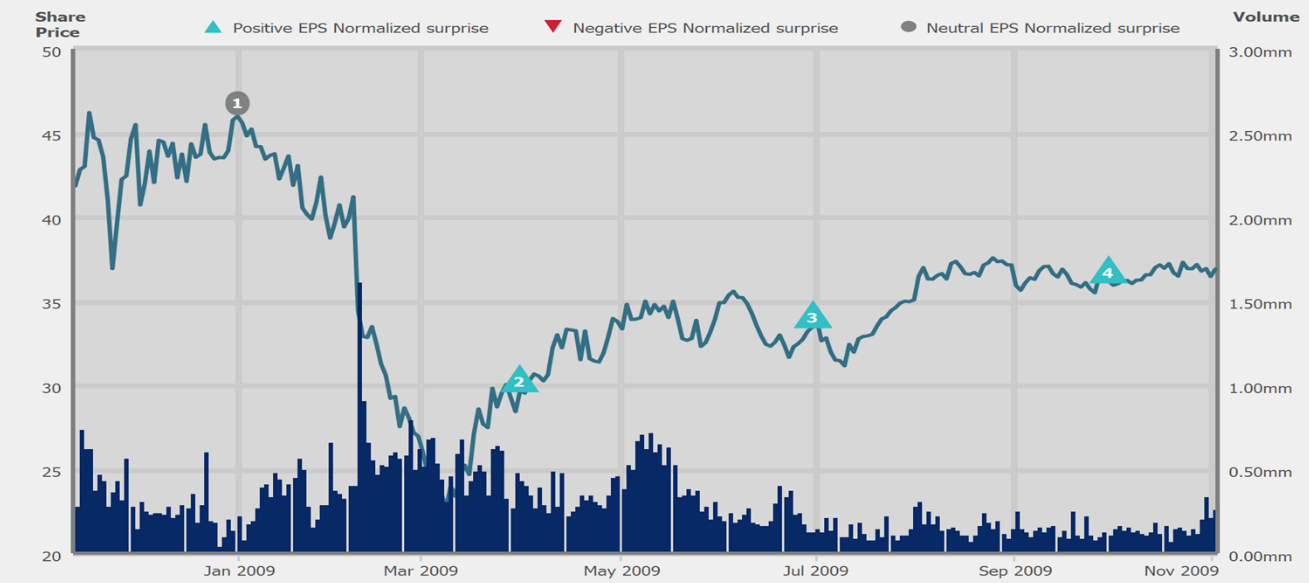
Monday, February 08, 2010 6:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2009-			-FQ1 2010-	-FY 2009-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.68	0.69	▲1.47	0.75	3.26	3.23
Revenue (mm)	606.28	618.92	▲2.08	640.72	2577.30	2589.97

Currency: USD
Consensus as of Feb-08-2010 4:17 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2008	0.78	(0.48)	NM
FQ1 2009	0.64	0.83	▲29.69 %
FQ2 2009	0.70	0.86	▲22.86 %
FQ3 2009	0.66	0.84	▲27.27 %

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Daniel D. Farrell
Macquarie Research

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

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

Presentation

Operator

Welcome to the Mercury General Fourth Quarter Conference Call. 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. [Operator Instructions] I would now like to turn today's 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 Fourth 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; and Robert Houlihan, Vice President and Chief Product Officer. Before we take questions, we will make a few comments regarding the quarter.

Our fourth quarter 2009 results improved significantly as compared to the fourth quarter of 2008. Year-over-year, our combined ratio improved from 113.4% in the fourth quarter of 2008 to 98.1% in the fourth quarter of 2009. The primary driver for the improved year-over-year results during the quarter was due to positive reserve development. Year-to-date, we recorded $58 million of positive reserve development on prior accident years, compared to $89 million of adverse development in 2008. In addition, our fourth quarter 2008 operating results were negatively impacted from the Southern California wildfires.

We have yet to receive Department of Insurance approval on our pending California auto rate fine. The pending funding includes a small rate increase, and introduces, among other things, new discounts and roadside assistance coverage. Based on recent discussions with the Department of Insurance, we believe the approval process should conclude within the next 30 to 60 days. We continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. We also recently introduced a new homeowners product in New Jersey.

The competitive environment continues to be challenging. Although premiums written declined 3.5% during the quarter to $618.9 million, this was an improvement over the 8%, 6.8% and 4.7% decline in the first, second and third quarter, respectively.

Despite the challenging environment in some of the states where we have implemented new rating plans, we have observed nice increases in new business submissions. We also expect our new rating plan in California, once implemented, to provide a lift to our new business submissions.

We are supporting the Continuous Coverage Auto Insurance Discount Act, a California ballot initiative which will be on the June 2010 ballot. If passed, the initiative will provide for a portable persistency discount, allowing insurance companies to offer new customers discounts based on having continuous insurance coverage from any insurance company. The initiative is pro consumer and will provide for a more competitive insurance marketplace, and will allow us to better compete for new customers.

Our new Mercury First front-end sales system has been deployed to three states. And we recently began a pilot deployment in California, and expect to begin the full rollout in California in March. Feedback from our agents on the new system continues to be positive.
During the month of January, we experienced a significant amount of rainfall in California, which resulted in an increase in claims for both our auto and homeowners line. Lastly, one number was transposed in the press release, the after-tax net investment income number for the fourth quarter was $32.1 million rather than the $23.1 million stated in the release. With that brief background, we will now take 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

Just a question on your reserves. Just tell me, I was thinking -- I guess I get a little confused with each quarter's press release. When you say the word prior period versus prior year, and you kind of flip-flop on what you say there. This quarter, you said prior period, and previously you said prior period. So that $58 million is all -- that sounds like that includes '09 plus '08 and prior?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Michael, this is Ted. The $58 million is prior accident year. So it's 2008 and prior, the majority of which was the 2008 accident year. And the $89 million that we referred to is prior accident years as well.

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

And then last quarter, third quarter, you said $40 million of prior year?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That's 2008 and prior accident year.

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

So nowhere in there are you talking about that, because before you talked about a $14 million for accident period 2009. That's not in any of these numbers?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, as you recall after last quarter, we discontinued showing those numbers.

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

And help me understand this Prop 17 thing, and you mentioned it here. How does allowing that make for a more competitive environment?

Gabriel Tirador
Chief Executive Officer, President and Director

Well today, companies are allowed to offer what's called a loyalty discount in the state of California, which if an insured has been with a respective company for a certain period of time, they're allowed to provide a discount. But if they move to a new insurance company, we're not able to offer that discount. So they lose that discount. They can't take that discount with them. And this will provide companies the ability to provide that discount to new customers, which will make for a much more competitive environment.

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

So I guess when you say competitive, you mean lower rates is kind of what you're saying?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes, absolutely.

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

I think of competitive as -- have you done some kind of analysis on your current book that says how much of those would receive a discount versus would receive a surcharge? Or is that coming to play here at all? Are there any chance...

Gabriel Tirador
Chief Executive Officer, President and Director

Well again, our existing book, those that are currently insured with us are currently getting a discount because they've been insured with us.

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

But there's a possibility for a surcharge with this change if it happens?

Gabriel Tirador
Chief Executive Officer, President and Director

A possibility for a surcharge? We keep our discount at the same level. There is no surcharge for those insurers.

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

So no possibility?

Gabriel Tirador
Chief Executive Officer, President and Director

No.

Operator

Your next question comes from the line of Jay Cohen with Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

It's Alison Jacobowitz actually. So I just want to make sure I didn't screw up my calculation then on the prior year reserve development, was it $18 million in the quarter?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Correct.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And then also, the tax rate, I also want to know was it higher on the -- I think I got it right with the transposed number for net investment income and realized gains. Was the tax rate higher on the regular GAAP underwriting this quarter?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I don't think so. It may be slightly higher due to year-end provision adjustments. But it should be about the same.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I thought I -- well, I'll call you offline, because I thought I got like a 48% tax rate if I moved everything in the other buckets correctly.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That doesn't sound right.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And then also could you quantify how much the wildfires were in the quarter?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

For '08 Q4, it was $20 million.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And I assume it's too early for you to quantify how much the January rainfall will be?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Right, yes.

Operator

[Operator Instructions] Your next question comes from the line of Cliff Canfield [ph] with Canfield Insurance.

Analyst

Do you consider this coming year hard or soft market?

Gabriel Tirador
Chief Executive Officer, President and Director

Well we consider it as hardening more than it's been. Let's put it that way. I wouldn't consider it a hard market, but as I mentioned earlier, we are seeing the rate of decline in our top line has improved for four consecutive quarters. So I wouldn't call it a hard market by all means, but we have certainly seen an improvement in that area over the last four quarters.

Analyst

Do you have any investments in real estate? I'm concerned mostly in the mortgage -secured commercial real estate.

Christopher Graves
Chief Investment Officer and Vice President

Cliff, this is Chris Graves. We have about $100 million in collateralized mortgage obligations. We do not any investments in commercial mortgage-backed. And that portfolio average rating is I think it's Aa1/AAA. But it's a solid portfolio still.

Analyst

Could you project the next year about how many states, say, in the next year or two, you hope to enter?

Gabriel Tirador
Chief Executive Officer, President and Director

I'll just talk about 2010 for right now. 2010 right now, we are not anticipating entering any new states in 2010. I'm not going to discuss '11. It's premature for that now. But '10 we're not participating, although we are anticipating adding some product lines in the existing states that we're in.

Analyst

Have you decided to stay in the state of Michigan?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we're still in Michigan. It continues to be a very, very small piece of our overall business. I think we're writing less than, what is it Ted, 5 million a year?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes.

Gabriel Tirador
Chief Executive Officer, President and Director

Something like that in Michigan. It's not significant, and it's not something that we're pushing right now. Let's put it that way, Cliff.

Operator

Your next question comes from the line of Michael Phillips with Stifel, Nicolaus.

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

Can you talk about what type of specific rate actions you've been taking in non-California states?

Robert Houlihan
Chief Product Officer and Vice President

In terms of rate actions, we've mainly been taking increases in some of the states where we're not hitting our profitability targets, trying to focus on that aspect of our results. And we've been introducing new products and new segmentation to try and get some growth at the same time while we're addressing profitability.

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

And as far as that profitability number, can you kind of throw the range of what that would be on the loss ratio side? Where is that for you? Where you'd like to be?

Robert Houlihan
Chief Product Officer and Vice President

Where do we like -- our targeted low states, I would say, is in the mid- to low-50s.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, I mean, it's going to vary by state depending on the expense structure of each state. The loss ratio will vary to target. But our overall target is to have a combined of 95%.

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

Have you seen any change in drivers, I guess, willingness or maybe propensity to sue on the DI [Disability Insurance] side, because of the last year economic fall off?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, the frequency in DI, Ted [ph], really hasn't -- it's been flat to actually down a little bit. So we haven't seen a propensity on the frequency numbers with respect to that.

Operator

Our next question comes from the line of Dean Evans with KBW.

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

First, looking at the total PIF count, the rate of decline has definitely seem to moderate as the years gone by, and ended down around 1%. I guess I was wondering what your thoughts are on that going forward? And when maybe you'd expect to see positive PIF growth?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I'm not going to estimate when we'll see positive PIF growth. But as I mentioned below, I think, earlier I should say, I think that we've seen just over the course of the year improved top-line numbers with respect to growth. And in the first quarter, something like 8% negative growth. And now we're down in the fourth quarter to about 3.5% negative growth. And I wouldn't be surprised if that continues to improve in 2010.

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

Looking at the expense ratio side kind of changing gears a bit, the fourth quarter was sort of a tick up from the second and third quarter. And I guess wanted to get your thoughts on the expense ratio going forward, and really is there any actions you're taking to cut expenses given the softening environment, or anything else we should be aware of?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

One of the reasons, as Gabe mentioned earlier, why the expense ratio ticked up is we're supporting the ballot initiative for next June. And so, there were certain costs in the fourth quarter associated with our support of that initiative. Looking forward, I think we'll be looking at expense ratios in the 28.5 to 29 range, at least that's kind of where we're pegging them to be for '10.

Gabriel Tirador
Chief Executive Officer, President and Director

And I would just add that last year, we took some actions to address our cost levels. We had some cost reductions, and we had some reductions in force. But at the end of the day, if the top line gets growing again and things start to turn around from the top-line standpoint, it's going to help the expense ratio.

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

What were the exact costs in the fourth quarter associated with the ballot initiative?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

$3.5 million.

Operator

Your next question comes from the line of Corey Bland [ph] with Peco and Company [ph].

Analyst

Are you going to disclose your numbers by state, combined ratios and premiums?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

No.

Analyst

You've done a lot of expanding over the last 10 years, and going into different states. At what point do you make a decision that you're going to exit a state that you've gone into?

Gabriel Tirador
Chief Executive Officer, President and Director

At the point where we think that, which hasn't occurred, at the point where we think that we just can't make it work. We've made some mistakes in going in some of these new states, and we've learned from those mistakes. And we feel pretty confident that we're going to be able to turn those states around, and hit our target of a 95% combined ratio. If we felt that we cannot hit that target for various reasons or for whatever reason, we wouldn't be in the state.

Analyst

So you have no plans on exiting any place that you're at right now?

Gabriel Tirador
Chief Executive Officer, President and Director

No.

Analyst

And what is your market share looking like in California these days?

Gabriel Tirador
Chief Executive Officer, President and Director

Our market share has been about between 9% and 10% or so.

Operator

[Operator Instructions] Your next question comes from the line of Dan Farrell with Macquarie.

Daniel D. Farrell
Macquarie Research

I just want to talk a little bit about your non-California business a little bit more, if you could. And just could you talk a little more generally maybe about what you think needs to happen to improve profitability there? And first, my guess is that, that's still the area that's running higher obviously than the California business and puts you further from your raw targets. But you have been putting rate changes through in several of those states, just your expectations of what it takes to kind of get that moving better? How long will some of those things take hold? Is it an issue of adding some more segmentation, or things like that into those markets?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, I think it's a couple of items. One, definitely adding more segmentation into those markets. We have been in the process of implementing what we're referring to here inside the company as the aligned [ph] product outside of California, which improves segmentation significantly. In addition to that, overall rate adequacy, we've been taking rate increases in many of our markets, Florida, New York, New Jersey. So we think that we're close. We think that 2010 is going to be much better than '09. And in some other markets, it takes a little bit a while, because as an example, New Jersey, we cap our rate increases. So as those rate caps become undone, we're going to be earning more premium in that state. So depending on the regulatory environment in the state and how quickly you can react to the pricing changes, is what really differentiates how fast you can do. You can get to a 95 in one state versus another state. But in total, we're -- I just wanted to state that we think '10 is going to be much better than '09 outside of California, and get us much closer to that target.

Daniel D. Farrell
Macquarie Research

Is some of it an expense issue in those states as well, because of the shrinkage? Or is it more in the loss side?

Gabriel Tirador
Chief Executive Officer, President and Director

Some of it is both. It depends on the state.

Operator

[Operator Instructions] And at this time, we have no further questions.

Gabriel Tirador
Chief Executive Officer, President and Director

Okay. Well, I'd like to thank everyone for participating on the call. And we'll talk to you again next quarter. Thank you.

Operator
Ladies and gentlemen, this concludes today's conference call. You may now disconnect.