S&P Capital IQ

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Mercury General Corporation NYSE:MCY

FQ1 2010 Earnings Call Transcripts

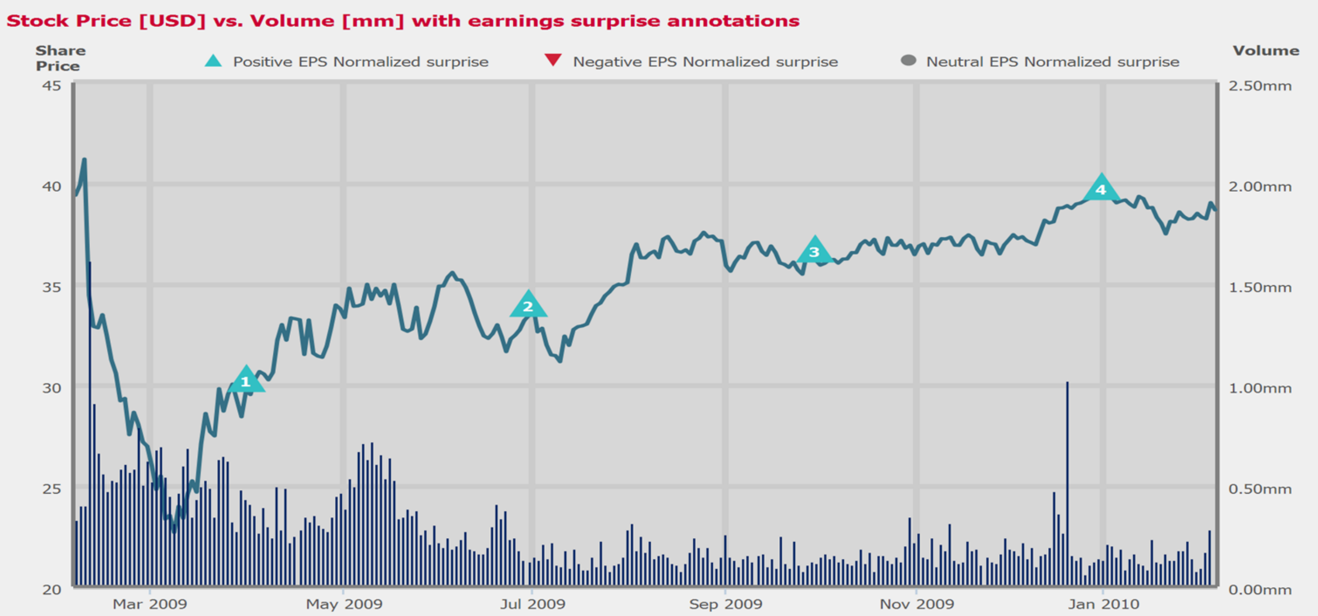
Monday, May 03, 2010 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2010-			-FQ2 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.68	0.85	▲25.00	0.76	2.96	3.01
Revenue (mm)	676.78	652.46	▼(3.59 %)	671.55	2599.00	2586.70

Currency: USD

Consensus as of May-03-2010 3:07 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2009	0.64	0.83	▲1 29.69 %
FQ2 2009	0.70	0.86	▲2 22.86 %
FQ3 2009	0.66	0.84	▲3 27.27 %
FQ4 2009	0.68	0.69	▲4 1.47 %

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

Caroline Steers
Macquarie Research

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

Tom Moritz

Presentation

Operator

Good afternoon. My name is Ashley, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General quarterly 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. 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, 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 our first quarter results continued our trend of improving operating results. Year-over-year, our combined ratio improved from 96.9% in the first quarter of 2009 to 96.3% in the first quarter of 2010. We recorded $20 million of positive reserve development on prior accident years during the quarter compared to $21 million in 2009. The first quarter 2010 results were negatively impacted by severe weather in the Northeast as well as a significant amount of rainfall in California during the month of January. We estimate the combined dollar impact for these events at about $5 million. As previously reported, the results for the first quarter of 2009 were negatively impacted by $8 million in severance-related expenses and $12 million in accelerated amortization of deferred policy acquisition cost related to the AIS acquisition.

As we have reported in previous quarters, we have an auto rate filing pending approval in California. The pending filing includes a small rate increase and introduces, among other things, new discounts and roadside assistance coverage. The approval of the rate filing has taken longer than we anticipated. The Department of Insurance's most recent update is that their actuary is expected to complete the review within the next three to four weeks. In other states, we continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy.

The competitive environment continues to be challenging. Although premiums written declined 2.7% during the quarter to $652.5 million, this was an improvement over the 3.5%, 4.7% and 6.8% decline in the fourth, third and second quarter of 2009 respectively. In addition, Personal Auto Policies-in-Force increased on a sequential basis for the first time in over 14 quarters. Personal Auto Policies-in-Force increased from 1,279,000 policies at December 31, 2009 to 1,284,000 policies at March 31, 2010. It is difficult to predict that this trend will continue, but it certainly was a positive development during the quarter.

We are continuing our support of Proposition 17, the Continuous Coverage Auto Insurance Discount Act. Proposition 17 is a California ballot initiative which will be on the June 8, 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. We expect increased expenditures in the second quarter of 2010 from our continued support of the initiative.

Our new Mercury First front-end sales system has been deployed to three states, and we recently launched the rollout of the system in California. We have deployed Mercury First to 465 agents in

California with the goal of full deployment by June 2010. Feedback from our agents on the new system continues to be positive.
With that brief background, we will now take questions.

Question and Answer

Operator

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

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

How much of this development that you see in fractionators '08 and '09 [ph] you've been talking about and seeing recently, how much of that do you attribute to the overall state of your state's economy versus anything else? Whatever else that might be. Is it more the recession related or is it other things?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, Michael, it's probably two components. We're seeing less late reported claims than we have over the past several years and that's definitely helping. As far as why our average severities have been benign, there's a lot of factors that go into that. Outside of California, we've been very aggressive in managing our claims and putting some of the processes we have in California into those other states. And within California, we continue to strongly defend our claims, and we're seeing a pretty benign trend there as well.

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

Is that last piece of strongly defending the claims, is that something that's been a change in the past couple years?

Gabriel Tirador
Chief Executive Officer, President and Director

There really hasn't been a change the last couple years. What it really comes down to is that our estimate last year was just for severity, which I think we were recording in the high-single digits, low-double digits, just proved to be too high.

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

Okay. And I guess if you had to think about whether it's kind of the severity or that late reported, it sounds like it's more of the severity issue if you had to rank the two than the late reported. First, is that true?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

This quarter, they're fairly equal.

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

How much, on that second issue, on the late reported, for a given accident year, how many claims do you typically see reported after an accident year has closed?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

For BI, we have a table in the 10-K but it's typically in California, 5% to 7% in the year after. For example, last year it was in the low-single digits, I think 2% or 3%.

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

2% or 3% relative to that 5% to 7% that's kind of typical, I guess.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes.

Operator

Our next question comes from the line of Caroline Steers with Macquarie.

Caroline Steers
Macquarie Research

What were the costs on the expense ratio related to Prop 17 in the first quarter?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

They were nil.

Caroline Steers
Macquarie Research

And then if you could just comment on your non-California business, the profitability there and if you could just talk about both homeowners and auto?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we're making improvements in the auto line outside of California. As I mentioned in my prepared remarks, we continue to take significant steps to improve the profitability outside of California. And we're seeing some very positive results as a result of that in some of our larger states, for example, in New Jersey. So that trend continues to improve outside of California, and we're going to continue to be aggressive, both from an overall pricing adequacy standpoint and also improving our segmentation. So that trend is very positive. On the homeowners front, we're also taking rate action where necessary outside of California. Inside of California, the results were still very good. In the quarter, we did have -- year-over-year, the combined ratio was up a little bit in California. Homeowners, as a result of the range that I mentioned in my prepared remarks. So overall, we're seeing some positive trends. The one area that we continue to have some issues with is the Florida Sinkhole issues in Florida homeowners which we're in the process of determining what next steps we need to take there.

Operator

And our next question comes from the line of Tom Moritz with Crowell, Weedon.

Tom Moritz

On Prop 17, can you give us any kind of handicapping or thoughts about the ballot and passage? And also on the investment portfolio, any outlook in terms of investment income and after-tax yield going forward on the portfolio?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, on the Prop 17, we believe this is a very, very much a pro-consumer bill. It's going to allow 80% of customers to qualify for a discount when they switch insurers and really have no impact on the other 20%. So we feel strongly about the proposition, we feel it's such a pro-consumer bill that we feel good about it overall. So I'm not going to try to handicap it but we think it's a very good bill, or I should say proposition. On the investment side, Chris, you want to take that.

Christopher Graves

Chief Investment Officer and Vice President

Tom, I think the run rate is around $137 million on investment income and it's probably about where it comes out for the year. And then after-tax yield, hopefully higher from here. I've got, I don't know what Ted has got calculated. My calculation is around the 430 and that's my own internal number. I hate to give you something that's different from Ted.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well the after-tax yields at 4.1.

Operator

[Operator Instructions] We do have a question from the line of Michael Phillips with Stifel, Nicolaus.

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

On the Prop 17, you said 80% of customers would qualify for discount when they switch insurers. So you benefit when they switch to you. I guess is there any reason why you would expect them, more customers to switch to you versus switch to competitors?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, we believe we have very competitive products. And when we had this discount that was allowed back in from, really, we had a puttable persistency from 1995 to 2005. We grew the company fairly well during that period, and we just feel that we like to compete for new business and it just makes it much more difficult today when other carriers can offer a discount and we can't. It keeps that insured locked into that carrier. So we're willing to compete on a level playing field with anybody.

Operator

And there are no further questions in queue at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I'd like to thank everybody for joining us on the call today, and we look forward to talking to you next quarter. Thank you very much.

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