

MERCURY GENERAL CORP  
Form 10-Q  
November 07, 2007

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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the Quarter Ended September 30, 2007

Commission File No. 001-12257

## MERCURY GENERAL CORPORATION

(Exact name of registrant as specified in its charter)

<b>California</b> (State or other jurisdiction of incorporation or organization)	<b>95-2211612</b> (I.R.S. Employer Identification No.)
<b>4484 Wilshire Boulevard, Los Angeles, California</b> (Address of principal executive offices)	<b>90010</b> (Zip Code)
<b>Registrant's telephone number, including area code:</b> <b>(323) 937-1060</b>	

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in the Rule 12b-2 of the Exchange Act). YES  NO

At October 31, 2007, the Registrant had issued and outstanding an aggregate of 54,721,501 shares of its Common Stock.

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## PART 1 FINANCIAL INFORMATION

## Item 1. Financial Statements

## MERCURY GENERAL CORPORATION

## AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

Amounts expressed in thousands, except share data

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost \$2,834,897 in 2007 and \$2,851,715 in 2006)	\$ 2,855,325	\$ 2,898,987
Equity securities available for sale, at fair value (cost \$312,392 in 2007 and \$258,310 in 2006)	417,132	318,449
Equity securities trading, at fair value (cost \$8,068 in 2007)	8,483	
Short-term investments, at cost, which approximates fair value	332,000	282,302
<b>Total investments</b>	<b>3,612,940</b>	<b>3,499,738</b>
Cash	47,920	47,606
Receivables:		
Premiums receivable	313,278	298,772
Premium notes	31,350	29,613
Accrued investment income	37,818	34,307
Other	11,497	10,085
<b>Total receivables</b>	<b>393,943</b>	<b>372,777</b>
Deferred policy acquisition costs	215,650	209,783
Fixed assets, net	165,946	152,260
Other assets	41,431	18,898
<b>Total assets</b>	<b>\$ 4,477,830</b>	<b>\$ 4,301,062</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Losses and loss adjustment expenses	\$ 1,097,678	\$ 1,088,822
Unearned premiums	973,799	950,344
Notes payable	130,980	141,554
Accounts payable and accrued expenses	142,756	137,194
Current income taxes	15,685	18,241
Deferred income taxes	32,756	33,608
Other liabilities	238,504	207,169
<b>Total liabilities</b>	<b>2,632,158</b>	<b>2,576,932</b>
Commitments and contingencies		
Shareholders' equity:		
Common stock without par value or stated value: (Authorized 70,000,000 shares; issued and outstanding 54,721,501 shares in 2007 and 54,669,606 shares in 2006)	69,006	66,436
Accumulated other comprehensive income	80,726	69,652

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Retained earnings	1,695,940	1,588,042
Total shareholders' equity	1,845,672	1,724,130
Total liabilities and shareholders' equity	\$ 4,477,830	\$ 4,301,062

See accompanying notes to the consolidated financial statements.

**MERCURY GENERAL CORPORATION**  
**AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

Amounts expressed in thousands, except share and per share data

	<b>Three Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Revenues:</b>		
Earned premiums	\$ 748,798	\$ 753,122
Net investment income	39,216	36,857
Net realized investment gains	2,049	2,690
Other	1,324	1,263
<b>Total revenues</b>	<b>791,387</b>	<b>793,932</b>
<b>Expenses:</b>		
Losses and loss adjustment expenses	497,791	491,129
Policy acquisition costs	166,496	163,362
Other operating expenses	41,289	45,813
Interest	2,136	2,209
<b>Total expenses</b>	<b>707,712</b>	<b>702,513</b>
<b>Income before income taxes</b>	<b>83,675</b>	<b>91,419</b>
Provision for income taxes	20,397	23,192
<b>Net income</b>	<b>\$ 63,278</b>	<b>\$ 68,227</b>
<b>BASIC EARNINGS PER SHARE</b> (weighted average shares outstanding 54,720,110 in 2007 and 54,662,245 in 2006)	<b>\$ 1.16</b>	<b>\$ 1.25</b>
<b>DILUTED EARNINGS PER SHARE</b> (weighted average shares 54,850,536 as adjusted by 130,426 for the dilutive effect of options in 2007 and 54,750,002 as adjusted by 87,757 for the dilutive effect of options in 2006)	<b>\$ 1.15</b>	<b>\$ 1.25</b>
<b>Dividends declared per share</b>	<b>\$ 0.52</b>	<b>\$ 0.48</b>

See accompanying notes to the consolidated financial statements.

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**MERCURY GENERAL CORPORATION**
**AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****Amounts expressed in thousands, except share and per share data**

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Revenues:</b>		
Earned premiums	\$ 2,258,626	\$ 2,243,152
Net investment income	122,156	112,502
Net realized investment gains	10,996	13,376
Other	3,896	3,729
<b>Total revenues</b>	<b>2,395,674</b>	<b>2,372,759</b>
<b>Expenses:</b>		
Losses and loss adjustment expenses	1,511,928	1,500,625
Policy acquisition costs	497,392	484,298
Other operating expenses	119,292	134,729
Interest	6,771	6,916
<b>Total expenses</b>	<b>2,135,383</b>	<b>2,126,568</b>
<b>Income before income taxes</b>	<b>260,291</b>	<b>246,191</b>
Provision for income taxes	67,051	81,506
<b>Net income</b>	<b>\$ 193,240</b>	<b>\$ 164,685</b>
<b>BASIC EARNINGS PER SHARE</b> (weighted average shares outstanding 54,697,145 in 2007 and 54,644,559 in 2006)	<b>\$ 3.53</b>	<b>\$ 3.01</b>
<b>DILUTED EARNINGS PER SHARE</b> (weighted average shares 54,829,878 as adjusted by 132,733 for the dilutive effect of options in 2007 and 54,759,549 as adjusted by 114,990 for the dilutive effect of options in 2006)	<b>\$ 3.52</b>	<b>\$ 3.01</b>
<b>Dividends declared per share</b>	<b>\$ 1.56</b>	<b>\$ 1.44</b>

See accompanying notes to the consolidated financial statements.

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**MERCURY GENERAL CORPORATION**
**AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)****Amounts expressed in thousands**

	<b>Three Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Net income	\$ 63,278	\$ 68,227
Other comprehensive income (loss) before tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains arising during period	29,821	28,427
Reclassification adjustment for net losses (gains) included in net income	2,419	(299)
Other comprehensive income before tax	32,240	28,128
Income tax expense related to unrealized holding gains arising during period	10,437	9,933
Income tax expense (benefit) related to reclassification adjustment for net losses (gains) included in net income	847	(104)
Comprehensive income, net of tax	\$ 84,234	\$ 86,526

See accompanying notes to the consolidated financial statements.

**MERCURY GENERAL CORPORATION**

**AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

**Amounts expressed in thousands**

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Net income	\$ 193,240	\$ 164,685
Other comprehensive income (loss) before tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains arising during period	21,348	2,181
Reclassification adjustment for net gains included in net income	(4,311)	(6,601)
Other comprehensive income (loss) before tax	17,037	(4,420)
Income tax expense related to unrealized holding gains arising during period	7,472	757
Income tax benefit related to reclassification adjustment for net gains included in net income	(1,509)	(2,310)
Comprehensive income, net of tax	\$ 204,314	\$ 161,818

See accompanying notes to the consolidated financial statements.

**MERCURY GENERAL CORPORATION**  
**AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

Amounts expressed in thousands

	Nine Months Ended September 30,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 193,240	\$ 164,685
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	19,486	17,803
Net realized investment gains	(10,996)	(13,376)
Bond amortization, net	4,264	3,371
Excess tax benefit from exercise of stock options	(203)	(489)
Increase in premiums receivable	(14,506)	(10,694)
Increase in premium notes	(1,737)	(3,966)
Increase in deferred policy acquisition costs	(5,867)	(15,777)
Increase in unpaid losses and loss adjustment expenses	8,856	42,461
Increase in unearned premiums	23,455	60,798
Increase in accounts payable and accrued expenses	5,562	18,872
(Decrease) Increase in accrued income taxes, excluding deferred tax on change in unrealized gain	(8,879)	20,872
Net increase in trading securities	(6,064)	
Share-based compensation	388	894
Other, net	(558)	7,719
 Net cash provided by operating activities	 206,441	 293,173
Cash flows from investing activities:		
Fixed maturities available for sale:		
Purchases	(1,419,283)	(1,817,114)
Sales	1,163,314	1,056,826
Calls or maturities	261,920	517,520
Equity securities available for sale:		
Purchases	(413,946)	(331,370)
Sales	376,903	308,309
Increase in payable for securities, net	4,085	21,638
Net (increase) decrease in short-term investments	(49,698)	32,025
Purchase of fixed assets	(32,437)	(22,533)
Sale of fixed assets	924	935
Other, net	(3,499)	9,273
 Net cash used in investing activities	 \$ (111,717)	 \$ (224,491)

(Continued)



**MERCURY GENERAL CORPORATION**  
**AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Continued)

	Nine Months Ended September 30,	
	2007	2006
Cash flows from financing activities:		
Dividends paid to shareholders	\$ (85,342)	\$ (78,719)
Proceeds from stock options exercised	1,979	1,866
Mortgage loan pay-off	(11,250)	
Excess tax benefit from exercise of stock options	203	489
Net cash used in financing activities	(94,410)	(76,364)
Net increase (decrease) in cash	314	(7,682)
Cash:		
Beginning of the period	47,606	69,784
End of the period	\$ 47,920	\$ 62,102
Supplemental disclosures of cash flow information:		
Interest paid during the period	\$ 8,618	\$ 8,490
Income taxes paid during the period	\$ 76,311	\$ 60,162
See accompanying notes to the consolidated financial statements.		

**MERCURY GENERAL CORPORATION & SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant assumptions in the preparation of these consolidated financial statements relate to losses and loss adjustment expenses. Actual results could differ materially from those estimates (See Note 1 Significant Accounting Policies of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2006).

The financial data of Mercury General Corporation and its subsidiaries (collectively, the Company ) included herein have been prepared without audit. In the opinion of management, all material adjustments of a normal recurring nature necessary to present fairly the Company s financial position at September 30, 2007 and the results of operations, comprehensive income and cash flows for the periods presented have been made. Operating results and cash flows for the nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Certain reclassifications have been made to the prior-period balances to conform to the current-period presentation.

**2. Recently Adopted Accounting Standards**

Effective January 1, 2007, the Company adopted the Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Un