Mercury General Corporation(MCY)

Updated April 24th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$49	**5 Year CAGR Estimate:**	5.2%	**Quality Percentile:**	N/A
Fair Value Price:	$46	**5 Year Growth Estimate:**	1.4%	**Momentum Percentile:**	N/A
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.3%	**Total Return Percentile:**	N/A
Dividend Yield:	5.1%	**5 Year Price Target**	$49	**Valuation Percentile:**	

Overview & Current Events

Mercury General is an insurance company that is active in the following businesses: Automobile, homeowners, renters & business insurance. Mercury was founded in 1961 and is currently valued at $2.7 billion. Personal automobile insurance is the most relevant business unit for Mercury General, the company is active in eleven states with California being the most important market. Insurance is primarily sold through about 10,000 independent agents.

The most recent quarterly results were announced in February: The company reported operating earnings of $1.64 during 2017 and held invested assets of $3.6 billion at the end of the most recent quarter

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.12	$3.23	$2.09	$2.79	$2.13	$2.18	$2.28	$2.34	$1.73	$1.64	***$2.55***	***$2.73***
DPS	$2.32	$2.33	$2.37	$2.41	$2.44	$2.45	$2.46	$2.47	$2.48	$2.49	***$2.50***	***$2.55***

Mercury's growth history is weak. From 2008 to 2017 its EPS have declined, and even when we exclude 2016's and 2017's results its growth rate through 2015 was just 1.4% -- not even beating inflation. 2016 and 2017 were two especially hard years, primarily due to unusually high costs from catastrophes such as the California wildfires during the summer of 2017. It is thus likely that earnings will recover substantially in 2018 as long as there is no unusually high number of catastrophes during the current year.

Going forward tax reform will also be beneficial for Mercury's profitability. As a US focused business, the company will benefit from lower corporate tax rates going forward, which should further boost this year's results. Since Mercury hasn't managed to grow its profits consistently over the last decade the growth outlook beyond 2018 is not overly strong, though. It is likely that the company will continue to grow its profits slightly, with relatively big swings on a year-over-year basis. These cyclical results are not unusual for insurance companies with a regional focus such as Mercury.

Mercury's dividend continues to grow despite the cyclicality of its profits, although the dividend growth rate has been very low during the last couple of years (annual increases of roughly half a percentage point since 2012).

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	22.6	10.8	20.1	14.5	19.6	20.1	21.5	23.1	30.8	35.0	***19.2***	***18.0***
Avg. Yld.	4.8%	6.7%	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	***5.1%***	***5.3%***

Mercury's valuation has risen to a very high level over the last two years, but that is primarily due to the unusually high profits during those two years. Based on this year's earnings Mercury trades at roughly 19 times earnings, which is slightly lower than the median earnings multiple of 20.8 over the last decade. Due to Mercury's low growth we believe that its multiple will not expand to the 20.8 median going forward, though. In the last couple of years Mercury's valuation had been relatively high due to the fact that the company's shares offer a compelling dividend yield. But since interest rates are rising, which means that income investors can increasingly invest into bonds instead of stocks for income generation, it is unlikely that the valuation will expand from the current level.

A 5.1% dividend yield is still attractive, thus excessive selling of Mercury's shares in order to deploy cash elsewhere is not likely either. The valuation is most likely to decline moderately as yields continue to rise over the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	62.3%	58.2%	57.4%	54.3%	56.1%	57.6%	59.1%	60.7%	63.5%	65.5%	***66.0%***	***68.0%***
Payout	109%	72.1%	113%	86.4%	115%	112%	108%	106%	143%	152%	***98.0%***	***93.4%***
Std. Dev.	56.7%	40.7%	17.9%	29.6%	17.6%	17.4%	17.9%	19.5%	22.0%	20.5%	***19.0%***	***21.0%***

Mercury's balance sheet looks solid: The company has a debt to assets ratio of roughly 66%, which is not a bad number for an insurance company at all. Commercial debt (notes payable) is at a very low level of just $370 million, the majority of the debt is non-interest bearing, including loss adjustment expense reserves of $1.5 billion and unearned premiums of $1.1 billion. The low amount of debt for which Mercury has to pay interest means that its interest expenses are very low. At the same time Mercury's investments produce a significant amount of interest earnings, which is why there is no net interest expense. As long as the investments Mercury has made continue to produce a meaningful yield (3.0% during 2017), the company's debt levels are not problematic at all.

During the last financial crisis Mercury remained profitable, which can be explained by the following two factors: Even during times when the economy is not strong at all people still need insurances for their cars, properties, etc. Demand for Mercury's offerings is thus not entirely dependent upon the economic environment. Mercury also did not invest in very risky assets prior to the financial crisis and therefore could avoid the big losses many other financial corporations had to report. Mercury overall is relatively recession-proof, the company is significantly more impacted by items that affect its operations directly, such as 2017's wildfires in California.

Final Thoughts & Recommendation

Mercury offers a high dividend yield, but little else. The company has a high payout ratio coupled with tepid growth prospects. Additionally, Mercury is not priced at bargain levels. The stock does not make for a compelling buy at current prices. Investors looking for high current income should consider Mercury shares only when the valuation multiple drops well below fair value.

Total Return Breakdown by Year