Mercury General (MCY)

Updated October 30th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$59	**5 Year CAGR Estimate:**	0.8%	**Volatility Percentile:**	61.1%
Fair Value Price:	$46	**5 Year Growth Estimate:**	1.4%	**Momentum Percentile:**	64.7%
% Fair Value:	128%	**5 Year Valuation Multiple Estimate:**	-4.9%	**Growth Percentile:**	3.7%
Dividend Yield:	4.3%	**5 Year Price Target**	$49	**Valuation Percentile:**	10.6%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	3.3%

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 $3.2 billion. Personal automobile insurance is the most important 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.

Mercury General reported its third quarter earnings results on October 29. Mercury General recorded revenues of $905 million during Q3, an increase of 9.4% compared to the previous year's quarter. Growth was driven by an $80 million increase in net written premiums. Mercury General's Q3 profits came in well above expectations, as Mercury General was able to generate earnings-per-share of $1.11 during the third quarter. Since Mercury General does not provide any guidance for fiscal 2018, we reaffirm our estimate for $2.55 in earnings-per-share for the current year. Since Mercury General has earned $2.06 during the first nine months of 2018, the $2.55 estimate seems realistic.

Mercury General has raised its dividend by 0.4% on October 29. The new quarterly payout is $0.6275 per share.

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***
Shares	54.8	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	***55.3***	***55.5***

Mercury's growth history is relatively weak. From 2008 to 2017 its earnings-per-share 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. During the first three quarters of 2018, earnings-per-share have recovered considerably due to lower catastrophic losses.

Tax reform will remain a tailwind for Mercury's profitability going forward. As a US-focused business, the company will benefit from lower corporate tax rates, which has already been visible during the first three quarters of 2018. Since Mercury has not 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.

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. The annual growth rate has averaged just half a percentage point over the last couple of years. Dividends thus grow at a slower pace than the rate of inflation.

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	***23.1***	***18.0***
Avg. Yld.	4.8%	6.7%	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	***4.3%***	***5.3%***

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Mercury General's shares have traded at a relatively high valuation throughout much of the last decade. This is primarily due to the relatively high dividend yield that Mercury General's shares have offered. As interest rates are rising, income focused investors have more alternative to stocks, which means that demand for stocks such as Mercury General will likely decline. We believe that Mercury General should not be valued at more than 20 times earnings.

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%***

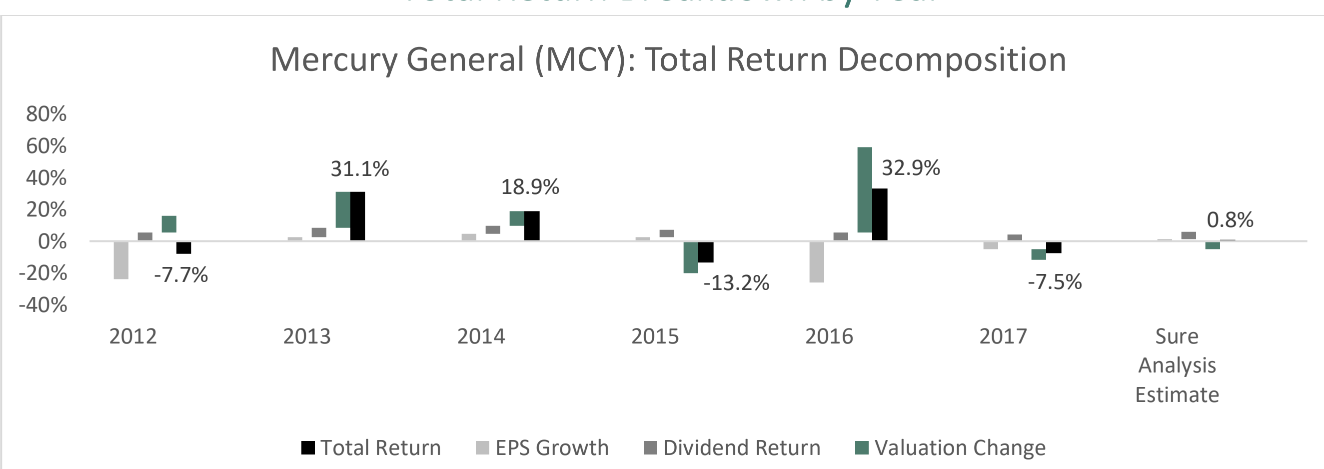
Mercury's balance sheet looks solid: The company has a debt to assets ratio of roughly 66%, which is not unusual for an insurance company. The majority of the liabilities are non-interest bearing, including loss adjustment expense reserves of $1.5 billion and unearned premiums of $1.2 billion. The low 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 income, which is why there is no net interest expense. As long as the investments Mercury has made continue to produce a meaningful yield 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, and other belongings. 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 General offers an above-average dividend yield, and the company has, in the past, not been vulnerable versus recessions. These are more or less the only positives, though. Mercury General has not produced attractive earnings growth rates, its results are cyclical (due to the impact of catastrophes), and the quite high valuation means that total returns will be weak going forward. Shares of Mercury General earn a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	2414	3121	2776	2777	2783	2821	3012	3009	3228	3416
D&A Exp.	27	36	41	41	37	31	28	48	53	55
Net Profit	-242	403	152	191	117	112	178	74	73	145
Net Margin	-10%	12.9%	5.5%	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%
Free Cash Flow	16	153	63	140	133	191	220	170	275	322
Income Tax	-209	168	30	54	18	20	69	-4	-2	22

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	3950	4233	4203	4070	4190	4315	4600	4629	4789	5101
Cash & Equivalents	35	186	181	211	158	267	290	264	220	291
Accounts Receivable	268	262	281	289	345	366	390	437	472	530
Goodwill & Int. Ass.	N/A	110	103	97	90	84	78	74	68	64
Total Liabilities	2456	2462	2409	2213	2347	2493	2725	2808	3036	3340
Accounts Payable	N/A	N/A	107	95	96	128	131	123	112	108
Long-Term Debt	159	271	267	140	140	190	290	290	320	371
Shareholder's Equity	1494	1771	1795	1857	1842	1822	1875	1821	1752	1761
D/E Ratio	0.11	0.15	0.15	0.08	0.08	0.10	0.15	0.16	0.18	0.21

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	-5.8%	9.9%	3.6%	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%
Return on Equity	-14%	24.7%	8.5%	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%
ROIC	-13%	21.8%	7.4%	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%
Shares Out.	54.8	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3
Revenue/Share	43.96	56.66	50.63	50.64	50.68	51.33	54.74	54.51	58.36	61.74
FCF/Share	0.29	2.77	1.15	2.56	2.42	3.48	4.01	3.08	4.97	5.82

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.