Mercury General (MCY)

Updated February 12th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	0.0%	**Volatility Percentile:**	59.4%
Fair Value Price:	$38	**5 Year Growth Estimate:**	1.4%	**Momentum Percentile:**	91.9%
% Fair Value:	141%	**5 Year Valuation Multiple Estimate:**	-6.5%	**Growth Percentile:**	3.5%
Dividend Yield:	5.1%	**5 Year Price Target**	$41	**Valuation Percentile:**	7.2%
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Total Return Percentile:**	2.8%

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 $2.8 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 fourth quarter and full year earnings results on February 11. The company generated revenues of $816 million during the fourth quarter, which was 4.7% less than the revenues that Mercury General was able to generate during the fourth quarter of 2017. Mercury General grew its net premiums written as well as its net premiums earned by a solid pace during the fourth quarter, as those rose by 9.2% and 7.6% year over year. The respectable growth rate in net premiums written bodes well for Mercury General's revenue growth during coming quarters. Mercury General's revenues were negatively impacted by net realized investment losses, which can be explained by the market turbulence during the fourth quarter of 2018. Mercury General was negatively impacted by higher catastrophe losses, adjusted for reinsurance payments. Those more than doubled from $20 million to $43 million between Q4 of 2017 and the most recent quarter.

Mercury General's earnings-per-share totaled -$0.26 during the fourth quarter, as higher catastrophe losses and net realized investment losses decimated Mercury General's bottom line. It is unlikely that this will repeat during coming quarters.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.23	$2.09	$2.79	$2.13	$2.18	$2.28	$2.34	$1.73	$1.64	$1.80	***$2.10***	***$2.25***
DPS	$2.33	$2.37	$2.41	$2.44	$2.45	$2.46	$2.47	$2.48	$2.49	$2.50	***$2.51***	***$2.60***
Shares	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	***55.3***	***55.3***

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.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	10.8	20.1	14.5	19.6	20.1	21.5	23.1	30.8	35.0	28.9	***25.2***	***18.0***
Avg. Yld.	6.7%	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	***5.1%***	***6.4%***

Mercury General's shares traded at quite high valuations throughout the last couple of years, with the company's price to earnings ratio being above 20 since 2013. Right now shares are still trading at a large premium to what we deem a fair valuation. This will pressure Mercury General's total returns considerably going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	72.1%	113%	86.4%	115%	112%	108%	106%	143%	152%	139%	***120%***	***116%***

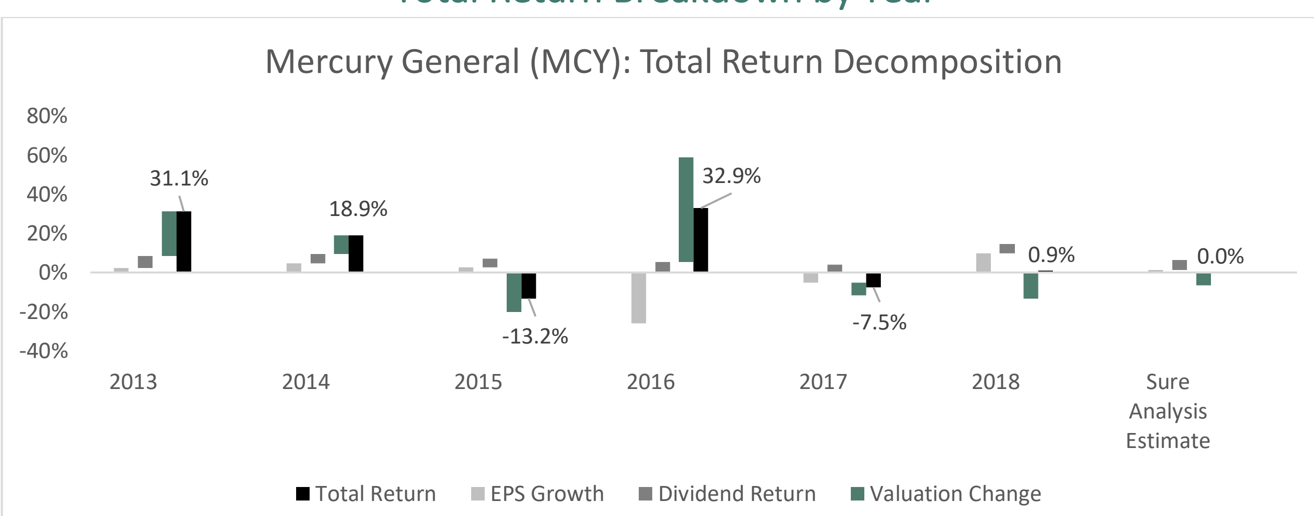
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company managed to increase its dividend payout throughout the years nevertheless, although the dividend growth rate was quite low in recent years at less than 1% annually. Mercury General has been able to finance its dividend thanks to cash flows that are higher than the net profits that the company generates.

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 very dependent upon the economic environment. Mercury also did not invest in very risky assets prior to the financial crisis, and therefore could avoid the unsustainable 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 was relatively resilient in the last financial crisis, which was not true for the majority of financial corporations. The company's shares offer an above-average dividend yield on top of that. Mercury General's earnings growth has been very inconsistent, though, and due to the high valuation (and correspondingly low expected returns) shares 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.