



# Mercury General (MCY)

Updated May 24<sup>th</sup>, 2019 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$57	<b>5 Year CAGR Estimate:</b>	7.5%	<b>Volatility Percentile:</b>	59.4%
<b>Fair Value Price:</b>	\$62	<b>5 Year Growth Estimate:</b>	1.4%	<b>Momentum Percentile:</b>	81.3%
<b>% Fair Value:</b>	92%	<b>5 Year Valuation Multiple Estimate:</b>	1.6%	<b>Growth Percentile:</b>	4.0%
<b>Dividend Yield:</b>	4.5%	<b>5 Year Price Target</b>	\$66	<b>Valuation Percentile:</b>	63.2%
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	36.1%

## 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 \$3.1 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 first quarter earnings results on April 29. The company generated revenues of \$1.02 billion during the first quarter, which was 30.2% more than the revenues that Mercury General was able to generate during the first quarter of 2018. Mercury General grew its net premiums written as well as its net premiums earned by a solid pace during the first quarter, as those rose by 6.4% and 7.7%, respectively, 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 also positively impacted by net realized investment gains, which can be explained by the market's ongoing recovery from global equity market turbulence during the fourth quarter of 2018. As stock markets rose during the first quarter, Mercury was able to capture share price gains on its investments. Mercury was also able to generate net investment income that was up from \$31 million during the previous year's quarter to \$34 million during Q1.

Mercury General's earnings-per-share totaled \$0.87 during the most recent quarter, beating the analyst consensus estimate easily. This was also significantly more than the \$0.07 that Mercury has generated during the previous year's quarter, although one-time items due to catastrophe losses can throw off that comparison.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$3.23	\$2.09	\$2.79	\$2.13	\$2.18	\$2.28	\$2.34	\$1.73	\$1.64	\$1.80	<b>\$3.62</b>	<b>\$3.88</b>
<b>DPS</b>	\$2.33	\$2.37	\$2.41	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	<b>\$2.51</b>	<b>\$2.60</b>
<b>Shares</b>	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	<b>55.3</b>	<b>55.3</b>

Mercury's growth history is relatively weak. From 2009 to 2018 its earnings-per-share declined, and even when we only look at the 2010 to 2015 time frame, earnings-per-share were down. 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 2018 Mercury's earnings-per-share have recovered somewhat due to lower catastrophic losses, but profits remained below the level from 2009, almost a full decade earlier.

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 was visible during 2018, and which will also be true in the future. Analysts are forecasting a strong recovery in Mercury's earnings-per-share during 2019 on the back of lower catastrophe losses and higher investment income. Beyond 2019, the company should 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 cyclicity 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.

*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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## 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	15.7	17.0
Avg. Yld.	6.7%	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	4.5%	3.9%

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. Based on current forecasts for this year's net profits, shares do finally look relatively fairly valued, or even slightly undervalued again. The dividend yield remains attractive.

## 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%	69.3%	67.0%

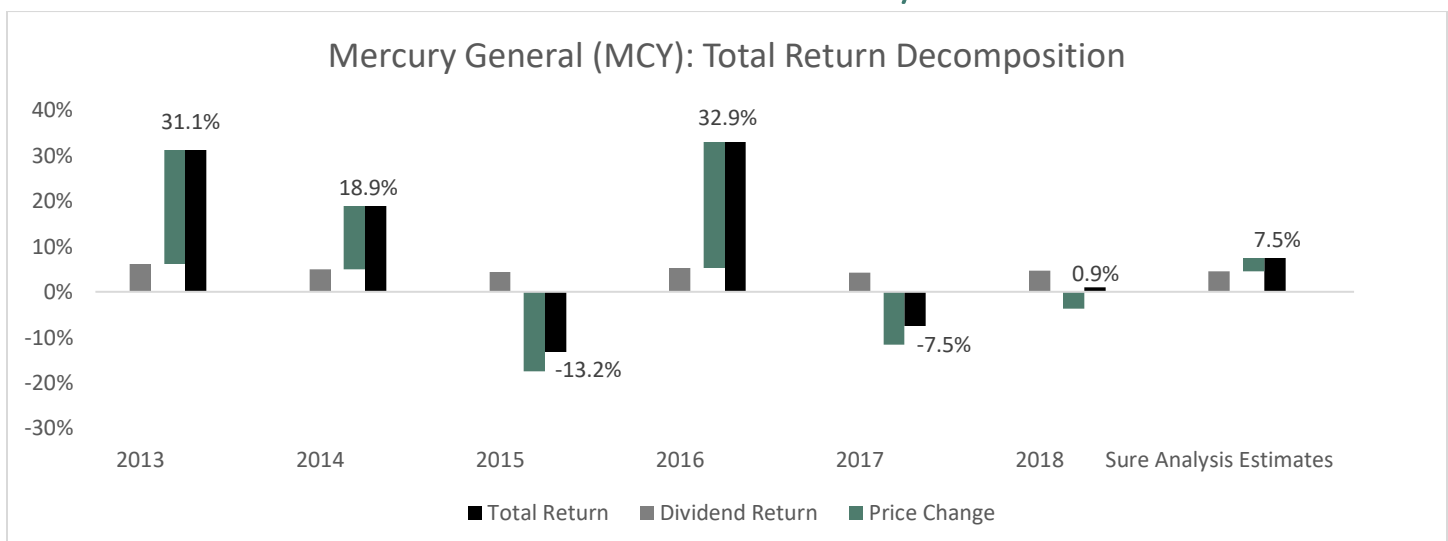
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company managed to increase its dividend payout throughout the years nevertheless, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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 insurance for their cars, property, 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 huge 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

Unlike most of its peers from the financial industry, Mercury General was relatively resilient during the last financial crisis. The company's shares offer an above-average dividend yield today. Mercury General's earnings growth has been very inconsistent, though, and even though analysts are forecasting a major earnings increase for 2019, catastrophes such as wildfires could negate this growth. We rate Mercury General a hold at the current level.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	3121	2776	2777	2783	2821	3012	3009	3228	3416	3380
<b>D&amp;A Exp.</b>	36	41	41	37	31	28	48	53	55	59
<b>Net Profit</b>	403	152	191	117	112	178	74	73	145	-6
<b>Net Margin</b>	12.9%	5.5%	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%
<b>Free Cash Flow</b>	153	63	140	133	191	220	170	275	322	355
<b>Income Tax</b>	168	30	54	18	20	69	-4	-2	22	-25

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	4233	4203	4070	4190	4315	4600	4629	4789	5101	5434
<b>Cash &amp; Equivalents</b>	186	181	211	158	267	290	264	220	291	314
<b>Accounts Receivable</b>	262	281	289	345	366	390	437	472	530	776
<b>Goodwill &amp; Int. Ass.</b>	110	103	97	90	84	78	74	68	64	58
<b>Total Liabilities</b>	2462	2409	2213	2347	2493	2725	2808	3036	3340	3816
<b>Accounts Payable</b>	N/A	107	95	96	128	131	123	112	108	115
<b>Long-Term Debt</b>	271	267	140	140	190	290	290	320	371	372
<b>Shareholder's Equity</b>	1771	1795	1857	1842	1822	1875	1821	1752	1761	1618
<b>D/E Ratio</b>	0.15	0.15	0.08	0.08	0.10	0.15	0.16	0.18	0.21	0.23

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	9.9%	3.6%	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%
<b>Return on Equity</b>	24.7%	8.5%	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%
<b>ROIC</b>	21.8%	7.4%	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%
<b>Shares Out.</b>	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3
<b>Revenue/Share</b>	56.66	50.63	50.64	50.68	51.33	54.74	54.51	58.36	61.74	61.08
<b>FCF/Share</b>	2.77	1.15	2.56	2.42	3.48	4.01	3.08	4.97	5.82	6.42

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

### Disclaimer

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