



Mercury General (MCY)

Updated September 5th, 2019 by Jonathan Weber

Key Metrics

Current Price:	\$56	5 Year CAGR Estimate:	5.4%	Volatility Percentile:	72.8%
Fair Value Price:	\$56	5 Year Growth Estimate:	1.4%	Momentum Percentile:	62.1%
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	0.0%	Growth Percentile:	6.8%
Dividend Yield:	4.6%	5 Year Price Target	\$60	Valuation Percentile:	62.4%
Dividend Risk Score:	D	Retirement Suitability Score:	D	Total Return Percentile:	35.0%

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 \$3.0 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 second quarter earnings results on July 29. The company grew its net premiums written by 6.6%, to \$936 million, and its net premiums earned by 6.6% as well, to \$889 million, during the second quarter. The respectable growth rate in net premiums written bodes well for Mercury General's revenue growth during coming quarters. Mercury General's growth pace was higher than what the analyst community had forecasted, beating the consensus by ~2%. Mercury General was able to generate net investment income of \$35 million during the quarter, which was marginally more than its net investment income during the previous year's quarter. Mercury General had to face higher catastrophe losses during the second quarter, though, which rose from \$2 million to \$9 million.

Mercury General's earnings-per-share totaled \$0.74 during the most recent quarter, missing the analyst consensus estimate widely, by \$0.29. This can be explained by significantly higher catastrophe losses, a development that more than offset the tailwinds from higher earned premiums.

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	\$3.30	\$3.54
DPS	\$2.33	\$2.37	\$2.41	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	\$2.51	\$2.56
Shares¹	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 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 harsh years, primarily due to unusually high costs for catastrophes such as the California wildfires during the summer of 2017. During 2018 Mercury's earnings-per-share have recovered slightly, 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, as catastrophe expenses are forecasted to decline on an annual basis, even though Q2 was not a strong quarter for the company. Beyond 2019, the company should be able to grow its profits slightly, we believe, although there will be relatively big swings on a year-over-year basis. These cyclical results are not unusual for insurance companies with a regional focus, and they are something investors have to live with when they want to invest into Mercury General.

Despite the large swings in its profitability, Mercury General has raised its dividend very consistently in the past.

¹ In Millions

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	17.0	17.0
Avg. Yld.	6.7%	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	4.6%	4.3%

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 look relatively fairly valued. The high 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%	76.1%	72.4%

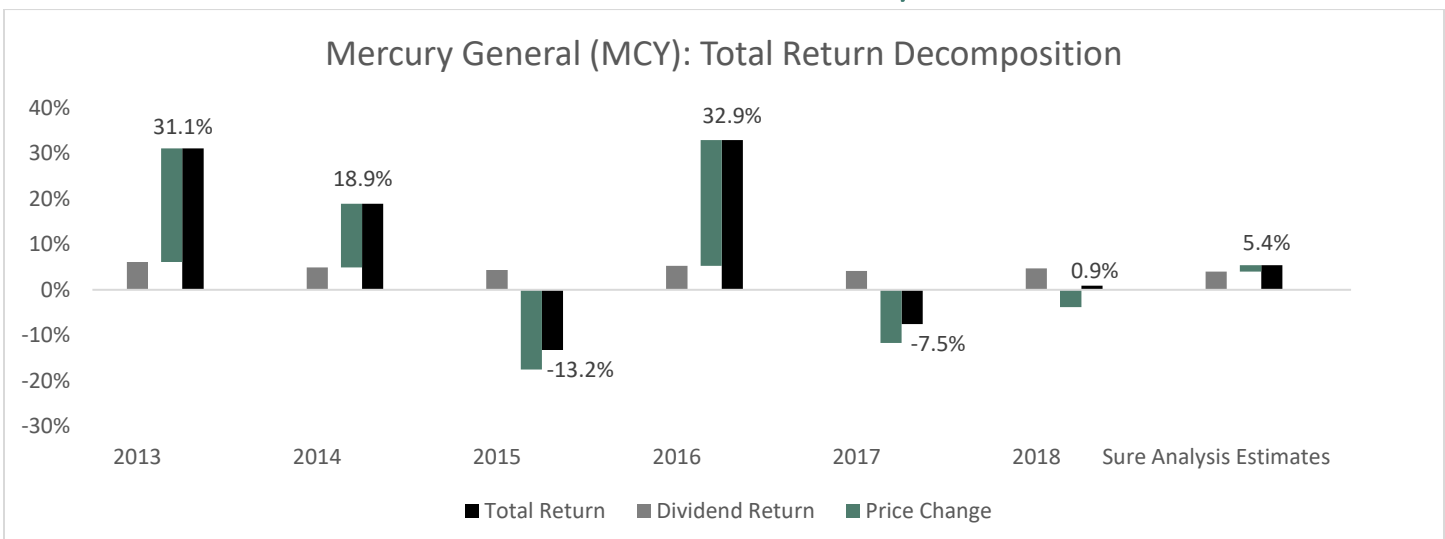
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company managed to increase its dividend payout throughout the years nevertheless, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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. First, even during times when the economy is weak, 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. Second, Mercury 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, as 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, unforeseen 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
Revenue	3121	2776	2777	2783	2821	3012	3009	3228	3416	3380
D&A Exp.	36	41	41	37	31	28	48	53	55	59
Net Profit	403	152	191	117	112	178	74	73	145	-6
Net Margin	12.9%	5.5%	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%
Free Cash Flow	153	63	140	133	191	220	170	275	322	355
Income Tax	168	30	54	18	20	69	-4	-2	22	-25

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	4233	4203	4070	4190	4315	4600	4629	4789	5101	5434
Cash & Equivalents	186	181	211	158	267	290	264	220	291	314
Accounts Receivable	262	281	289	345	366	390	437	472	530	776
Goodwill & Int. Ass.	110	103	97	90	84	78	74	68	64	58
Total Liabilities	2462	2409	2213	2347	2493	2725	2808	3036	3340	3816
Accounts Payable	N/A	107	95	96	128	131	123	112	108	115
Long-Term Debt	271	267	140	140	190	290	290	320	371	372
Shareholder's Equity	1771	1795	1857	1842	1822	1875	1821	1752	1761	1618
D/E Ratio	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
Return on Assets	9.9%	3.6%	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%
Return on Equity	24.7%	8.5%	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%
ROIC	21.8%	7.4%	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%
Shares Out.	54.8	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3
Revenue/Share	56.66	50.63	50.64	50.68	51.33	54.74	54.51	58.36	61.74	61.08
FCF/Share	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.

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