# Mercury General (MCY)

*Updated October 28th, 2019 by Jonathan Weber*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $47 | **5 Year CAGR Estimate:** | 8.2% | **Volatility Percentile:** | 73.7% |
| **Fair Value Price:** | $53 | **5 Year Growth Estimate:** | 1.5% | **Momentum Percentile:** | 12.7% |
| **% Fair Value:** | 89% | **5 Year Valuation Multiple Estimate:** | 2.3% | **Growth Percentile:** | 7.3% |
| **Dividend Yield:** | 5.4% | **5 Year Price Target** | $57 | **Valuation Percentile:** | 79.4% |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | D | **Total Return Percentile:** | 56.9% |

## 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 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 October 28. The company grew its revenues to $987 million, which was 10.3% more than Mercury's revenues during the previous year's quarter. Net premiums earned grew 6.6% year over year, to $915 million, while net written premiums came in even higher than that, at $983 million. The respectable growth rate in net written premiums bodes well for Mercury General's revenue growth during coming quarters. Mercury General's revenue growth was higher than what the analyst community had forecasted, beating the consensus by ~2%. Mercury General also was able to generate net investment income of $36 million during the quarter, which equates to a yield on investments of 3.2% on an after-tax basis. Mercury General's combined ratio weakened, however, to 98.6%, which is why Mercury's profitability came under pressure.

Mercury General's earnings-per-share totaled $0.78 during the third quarter, missing the analyst consensus estimate widely, by $0.30. This was due to the weakened combined ratio, which pressured Mercury's margins and which more than offset the positive growth in written and earned premiums. The company increased its dividend to $0.63 per share.

## 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 | ***$3.10*** | ***$3.34*** |
| **DPS** | $2.33 | $2.37 | $2.41 | $2.44 | $2.45 | $2.46 | $2.47 | $2.48 | $2.49 | $2.50 | ***$2.52*** | ***$2.58*** |
| **Shares**[1] | 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 & Q3 were not overly strong quarters 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.

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[1] In Millions

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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 | ***15.2*** | ***17.0*** |
| Avg. Yld. | 6.7% | 5.6% | 6.0% | 5.8% | 5.6% | 5.0% | 4.6% | 4.7% | 4.4% | 5.1% | ***5.4%*** | ***4.6%*** |

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 attractively valued. The dividend yield remains at an attractive level of more than 5%.

## 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% | ***81.3%*** | ***77.4%*** |

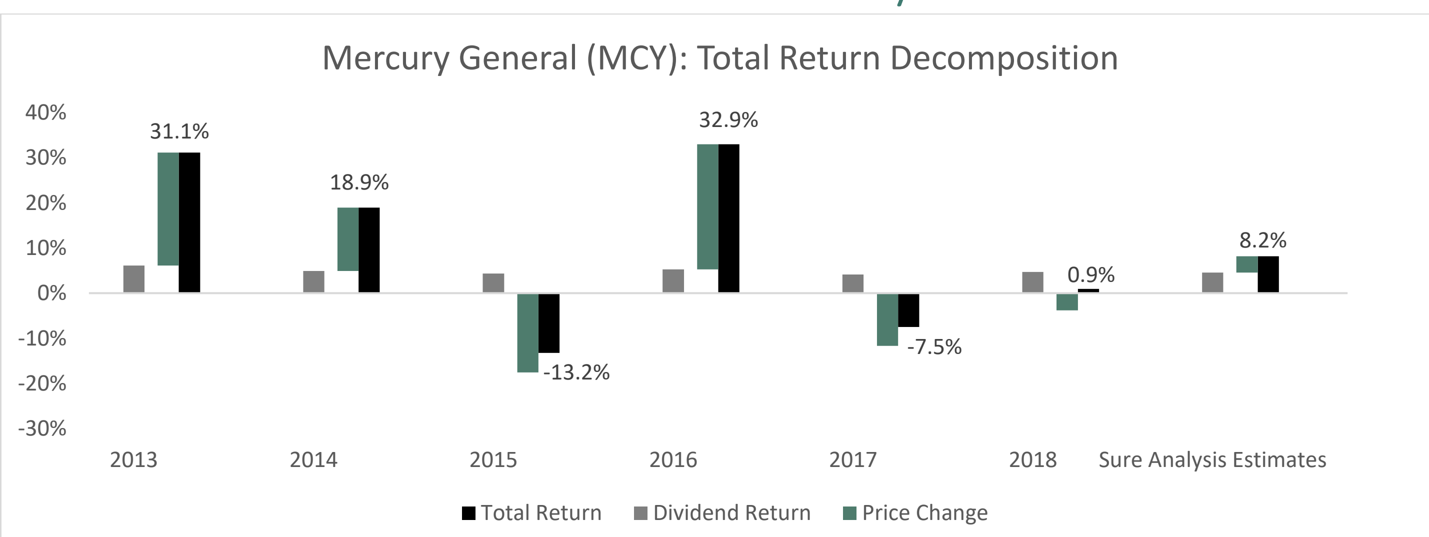
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company managed to increase its dividend payout throughout the years nevertheless, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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 two key 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, including insurance companies, 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, unforeseen catastrophes can always lead to swings in Mercury's profitability. We rate Mercury General a hold at the current level.

## 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 | 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.*