



Mercury General (MCY)

Updated February 13th, 2020 by Jonathan Weber

Key Metrics

Current Price:	\$51	5 Year CAGR Estimate:	7.0%	Market Cap:	\$2.8B
Fair Value Price:	\$54	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	03/16/20
% Fair Value:	94%	5 Year Valuation Multiple Estimate:	1.3%	Dividend Payment Date:	03/31/20
Dividend Yield:	4.9%	5 Year Price Target	\$59	Years Of Dividend Growth:	32
Dividend Risk Score:	F	Retirement Suitability Score:	D	Last Dividend Increase:	0.4%

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 earnings results on February 10. The company grew its net premiums earned to \$925 million, which was 6.6% more than Mercury's net earned premiums during the previous year's quarter. Net premiums written grew 5.4% year over year. The respectable growth rate in net written and net earned premiums bodes well for Mercury General's revenue growth during coming quarters. Mercury General's business growth was higher than what the analyst community had forecasted, as net earned premiums beat the analyst consensus by ~5%. Mercury General also was able to generate net investment income of \$36 million during the quarter, which equates to a yield on investments of 3.1% on an after-tax basis. Mercury General's combined ratio weakened, however, to 103.2%, which is why Mercury's profitability came under pressure during the most recent quarter.

Mercury General's earnings-per-share totaled \$0.21 during the fourth quarter, still beating the analyst consensus estimate by \$0.04. The weak profitability was due to the worse combined ratio, which pressured Mercury's margins and which more than offset the positive growth in written and earned premiums.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.09	\$2.79	\$2.13	\$2.18	\$2.28	\$2.34	\$1.73	\$1.64	\$1.80	\$2.60	\$3.20	\$3.45
DPS	\$2.37	\$2.41	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	\$2.51	\$2.52	\$2.58
Shares¹	54.8	54.9	54.9	55.0	55.1	55.2	55.3	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 2019 Mercury's earnings-per-share have recovered, however, due to lower catastrophe losses, but profits remained below the level that was hit in 2011, almost a decade earlier.

Following a solid 2019, analysts are forecasting an even better 2020, on the back of ongoing growth in Mercury's written and earned premiums, while investment income should be able to rise as well. Normalizing catastrophe losses, which were unusually high over the last couple of years, could also be a tailwind for Mercury going forward.

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, as there have been major changes in its profitability in the past. These cyclical results, caused by one-time impacts such as wildfires, 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.

¹ In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	20.1	14.5	19.6	20.1	21.5	23.1	30.8	35.0	28.9	18.8	15.9	17.0
Avg. Yld.	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	5.1%	4.9%	4.4%

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 between 2013 and 2018. 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 almost 5%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	113%	86.4%	115%	112%	108%	106%	143%	152%	139%	96.5%	78.8%	74.9%

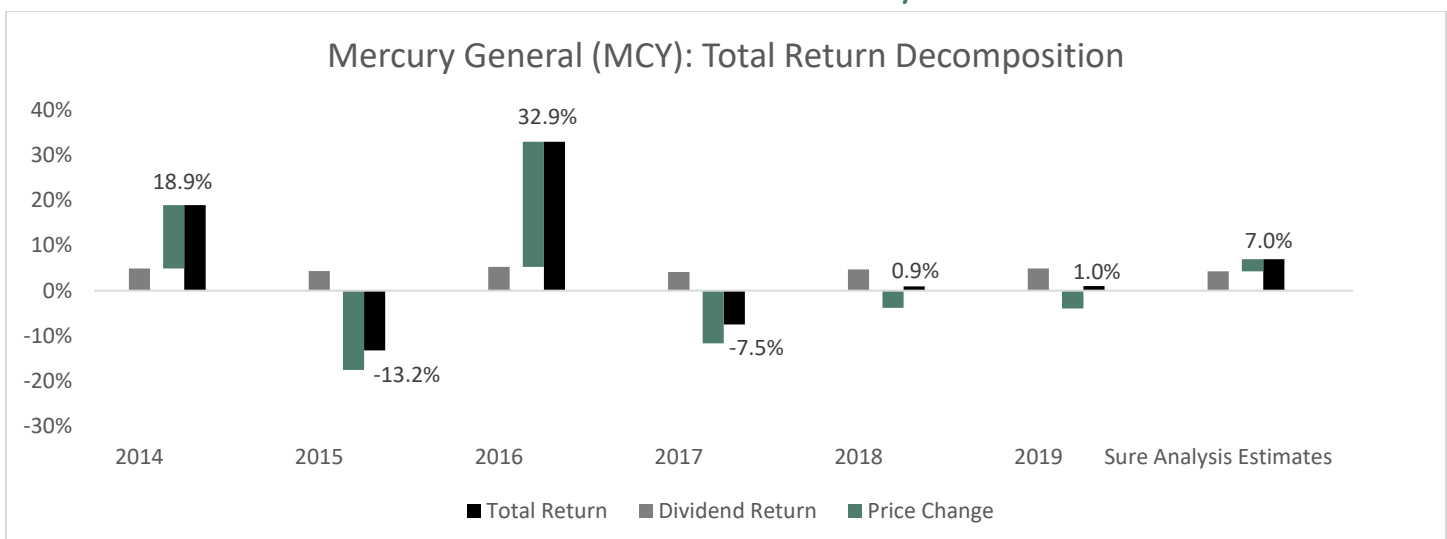
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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 2020, 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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2,776	2,777	2,783	2,821	3,012	3,009	3,228	3,416	3,380	3,973
D&A Exp.	41	41	37	31	28	48	53	55	59	65
Net Profit	152	191	117	112	178	74	73	145	(6)	320
Net Margin	5.5%	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%	8.1%
Free Cash Flow	63	140	133	191	220	170	275	322	355	
Income Tax	30	54	18	20	69	(4)	(2)	22	(25)	58

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	4,203	4,070	4,190	4,315	4,600	4,629	4,789	5,101	5,434	5,889
Cash & Equivalents	181	211	158	267	290	264	220	291	314	294
Accounts Receivable	281	289	345	366	390	437	472	530	776	684
Goodwill & Int. Ass.	103	97	90	84	78	74	68	64	58	53
Total Liabilities	2,409	2,213	2,347	2,493	2,725	2,808	3,036	3,340	3,816	4,090
Accounts Payable	107	95	96	128	131	123	112	108	115	143
Long-Term Debt	267	140	140	190	290	290	320	371	372	372
Shareholder's Equity	1,795	1,857	1,842	1,822	1,875	1,821	1,752	1,761	1,618	1,800
D/E Ratio	0.15	0.08	0.08	0.10	0.15	0.16	0.18	0.21	0.23	0.21

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	3.6%	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%	5.7%
Return on Equity	8.5%	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%	18.7%
ROIC	7.4%	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%	15.4%
Shares Out.	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3
Revenue/Share	50.63	50.64	50.68	51.33	54.74	54.51	58.36	61.74	61.08	71.76
FCF/Share	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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