



# Mercury General (MCY)

Updated November 12<sup>th</sup>, 2020 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$44	<b>5 Year CAGR Estimate:</b>	15.5%	<b>Market Cap:</b>	\$2.4B
<b>Fair Value Price:</b>	\$72	<b>5 Year Growth Estimate:</b>	1.5%	<b>Ex-Dividend Date:</b>	12/15/20
<b>% Fair Value:</b>	61%	<b>5 Year Valuation Multiple Estimate:</b>	10.4%	<b>Dividend Payment Date:</b>	12/30/20
<b>Dividend Yield:</b>	5.8%	<b>5 Year Price Target</b>	\$78	<b>Years Of Dividend Growth:</b>	33
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	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 nearly 60 years ago, in 1961. 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 third quarter earnings results on November 3. The company reported revenues of \$999 million for the quarter, which was up 1.2% compared to the previous year's period. Net premiums written declined 4% year over year, to \$942 million. The fact that net written premiums were down year over year will likely mean that earned premiums could be under pressure during coming quarters. Mercury General's investment income and investment gains improved by a lot during the quarter, as net realized investment gains rose to \$120 million for the quarter. Net investment income totaled \$32 million during the third quarter, down marginally compared to the previous year's period, due to a decline in the average yield on investments.

Mercury General's adjusted earnings-per-share totaled \$1.23 during the third quarter, missing the analyst consensus estimate. The adjusted result backs out one-time accounting gains during the quarter. The coronavirus does not have a meaningful impact on Mercury General's profitability so far. Thanks to a solid first nine months of 2020, the outlook for fiscal 2020 is quite positive, and Mercury General will likely exceed 2019's profits this year.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$2.09	\$2.79	\$2.13	\$2.18	\$2.28	\$2.34	\$1.73	\$1.64	\$1.80	\$2.60	<b>\$4.80</b>	<b>\$5.17</b>
<b>DPS</b>	\$2.37	\$2.41	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	\$2.51	<b>\$2.53</b>	<b>\$2.58</b>
<b>Shares<sup>1</sup></b>	54.8	54.9	54.9	55.0	55.1	55.2	55.3	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 the company's earnings-per-share declined. 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, despite the current pandemic. Normalizing catastrophe losses, which were unusually high over the last couple of years, should be a tailwind for Mercury going forward. Analysts are not forecasting a major negative impact from the coronavirus crisis on Mercury's operations, apart from the accounting loss during the first quarter, which was reverted in Q2.

In the future, the company should be able to grow its profits slightly, we believe, although there likely will be 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.

<sup>1</sup> 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	<b>9.2</b>	<b>15.0</b>
Avg. Yld.	5.6%	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	5.1%	<b>5.8%</b>	<b>3.3%</b>

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. This was mostly due to the below-average profitability during those years. Based on current earnings forecasts for 2020, Mercury's shares seem to be attractively valued.

## 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%	<b>52.7%</b>	<b>49.9%</b>

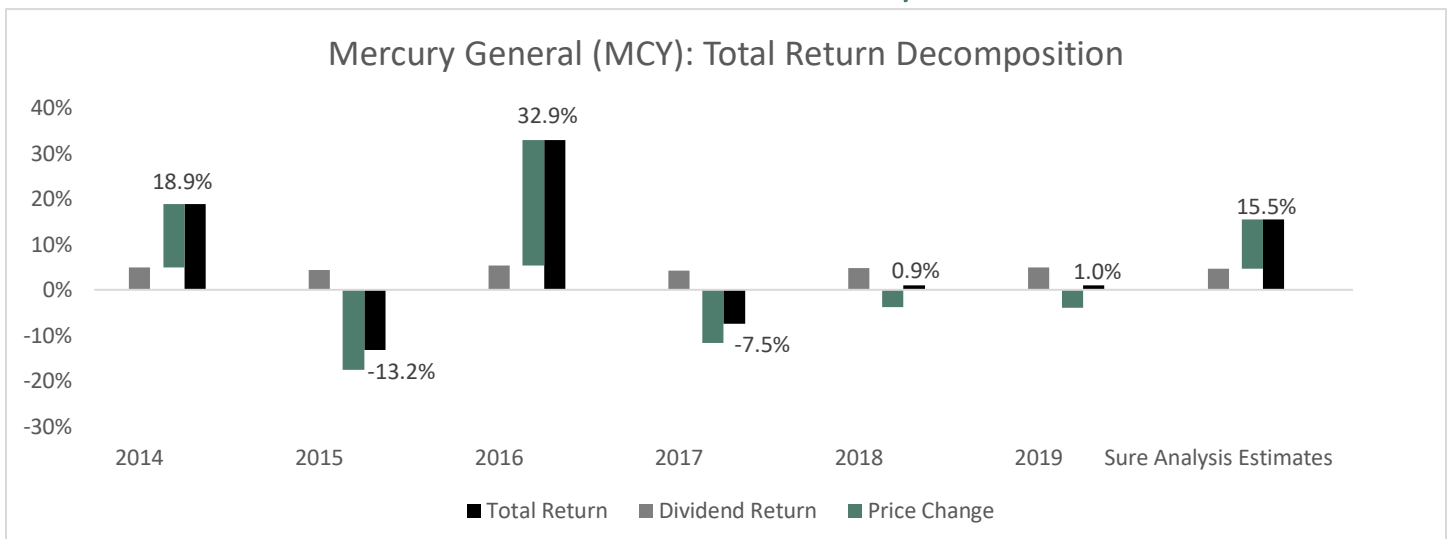
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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 overly dependent upon the economy. Second, Mercury did not invest in high-risk assets prior to the financial crisis, and therefore was able to avoid the huge losses many other financial corporations had to report. Mercury overall is recession-proof which is a plus during the current economic downturn, the company is significantly more impacted by catastrophes that affect its operations directly, such as 2017's huge California wildfires.

## Final Thoughts & Recommendation

Unlike most of its peers from the financial industry, Mercury General was relatively resilient during the last financial crisis. Mercury General's earnings growth has been very inconsistent, however, and even though analysts are forecasting a major earnings increase for 2020, unforeseen events such as wildfires or earthquakes can always lead to volatility. Due to the undervaluation and strong forecasted returns, we rate Mercury General a buy 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
<b>Revenue</b>	2,776	2,777	2,783	2,821	3,012	3,009	3,228	3,416	3,380	3,973
<b>D&amp;A Exp.</b>	41	41	37	31	28	48	53	55	59	65
<b>Net Profit</b>	152	191	117	112	178	74	73	145	(6)	320
<b>Net Margin</b>	5.5%	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%	8.1%
<b>Free Cash Flow</b>	63	140	133	191	220	170	275	322	355	
<b>Income Tax</b>	30	54	18	20	69	(4)	(2)	22	(25)	58

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	4,203	4,070	4,190	4,315	4,600	4,629	4,789	5,101	5,434	5,889
<b>Cash &amp; Equivalents</b>	181	211	158	267	290	264	220	291	314	294
<b>Accounts Receivable</b>	281	289	345	366	390	437	472	530	776	684
<b>Goodwill &amp; Int. Ass.</b>	103	97	90	84	78	74	68	64	58	53
<b>Total Liabilities</b>	2,409	2,213	2,347	2,493	2,725	2,808	3,036	3,340	3,816	4,090
<b>Accounts Payable</b>	107	95	96	128	131	123	112	108	115	143
<b>Long-Term Debt</b>	267	140	140	190	290	290	320	371	372	372
<b>Shareholder's Equity</b>	1,795	1,857	1,842	1,822	1,875	1,821	1,752	1,761	1,618	1,800
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	3.6%	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%	5.7%
<b>Return on Equity</b>	8.5%	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%	18.7%
<b>ROIC</b>	7.4%	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%	15.4%
<b>Shares Out.</b>	54.8	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3
<b>Revenue/Share</b>	50.63	50.64	50.68	51.33	54.74	54.51	58.36	61.74	61.08	71.76
<b>FCF/Share</b>	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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