



# Mercury General (MCY)

Updated August 16<sup>th</sup>, 2021 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$59	<b>5 Year CAGR Estimate:</b>	5.2%	<b>Market Cap:</b>	\$3.3B
<b>Fair Value Price:</b>	\$59	<b>5 Year Growth Estimate:</b>	1.5%	<b>Ex-Dividend Date:</b>	09/15/21
<b>% Fair Value:</b>	101%	<b>5 Year Valuation Multiple Estimate:</b>	-0.2%	<b>Dividend Payment Date:</b>	09/30/21
<b>Dividend Yield:</b>	4.3%	<b>5 Year Price Target</b>	\$63	<b>Years Of Dividend Growth:</b>	33
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	C	<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 more than 50 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 second quarter earnings results on August 3. The company reported revenues of \$960 million for the quarter, which was up 16% compared to the previous year's period. Net premiums written rose by 17% year over year as well. The fact that net written premiums were up significantly year over year will likely mean that earned premiums should see some growth during coming quarters. Mercury General's investment income and investment gains were down slightly year over year, despite still coming in at a solid level of \$31 million. Last year's Q2 had seen huge tailwinds from the recovery of the equity market selloff in Q1 2020, which is why this year's Q2 had a tough comparison versus the same quarter a year ago, which explains the small decline in investment gains.

Mercury General's adjusted earnings-per-share totaled \$1.13 during the second quarter, beating the analyst consensus estimate. The adjusted result backs out one-time accounting items. The coronavirus hasn't had a meaningful impact on Mercury General's profitability so far. 2020 was a strong year for Mercury, as earnings-per-share were higher than during all previous years, at \$5.54, although it is expected that 2021 will be a somewhat weaker year again.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$2.79	\$2.13	\$2.18	\$2.28	\$2.34	\$1.73	\$1.64	\$1.80	\$2.60	\$5.54	<b>\$3.90</b>	<b>\$4.20</b>
<b>DPS</b>	\$2.41	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	\$2.51	\$2.52	<b>\$2.53</b>	<b>\$2.59</b>
<b>Shares<sup>1</sup></b>	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3	55.4	<b>55.5</b>	<b>56.0</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 recovered, however, due to lower catastrophe losses, but profits remained below the level that was hit in 2011, almost a decade earlier.

2019 had been a solid year for Mercury, but profits during 2020 rose to a way higher level, partially due to below-average catastrophe losses. The pandemic did not negatively impact the company's results during 2020, and the same can be expected for the current year, but higher losses for Mercury's ordinary business are expected for this year.

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 or hurricanes 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. These are not tied to the underlying strength of the economy, however, which is why Mercury's cyclical nature is not tied to recessions.

<sup>1</sup> In Millions

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## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	14.5	19.6	20.1	21.5	23.1	30.8	35.0	28.9	18.8	9.2	15.1	15.0
Avg. Yld.	6.0%	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	5.1%	5.0%	4.3%	4.1%

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 2021, Mercury's shares trade in line with our fair value estimate.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	86.4%	115%	112%	108%	106%	143%	152%	139%	96.5%	45.5%	64.9%	61.7%

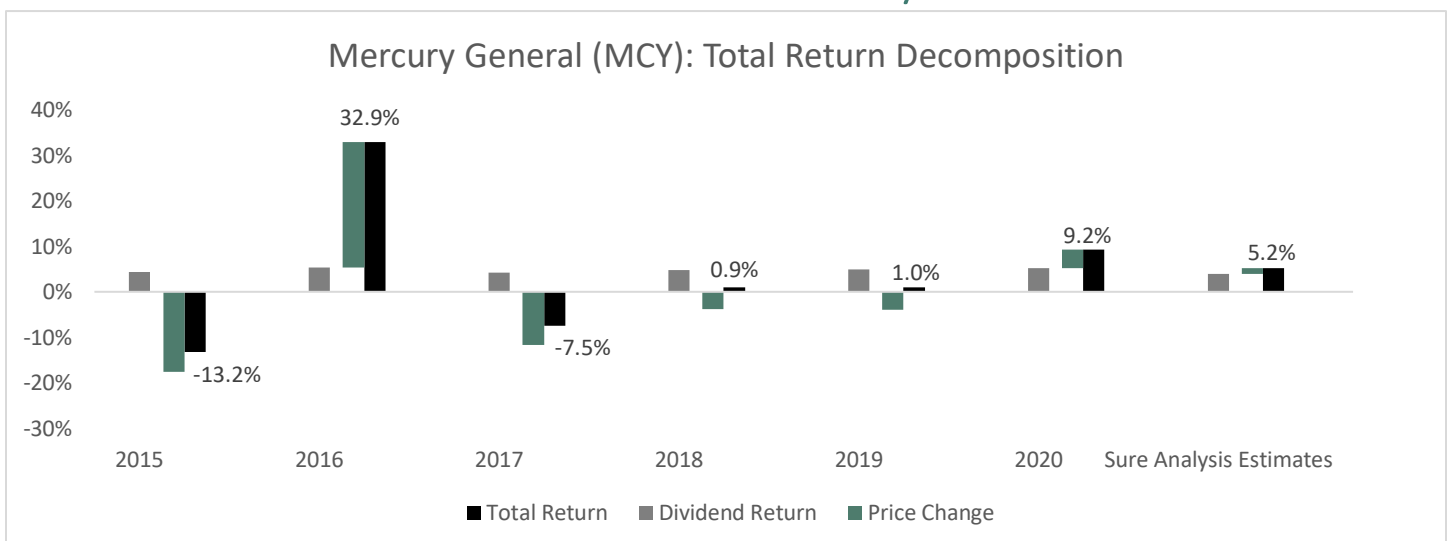
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General 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. But 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 2020 was a strong year, 2021 looks like it will be a weaker year once again. Unforeseen catastrophes such as wildfires can impact results to a large degree. Due to unconvincing expected returns, we rate Mercury General a hold at the current level.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Revenue</b>	2,777	2,783	2,821	3,012	3,009	3,228	3,416	3,380	3,973	3,785
<b>D&amp;A Exp.</b>	41	37	31	28	48	53	55	59	65	68
<b>Net Profit</b>	191	117	112	178	74	73	145	(6)	320	375
<b>Net Margin</b>	6.9%	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%	8.1%	9.9%
<b>Free Cash Flow</b>	140	133	191	220	170	275	322	355	480	566
<b>Income Tax</b>	54	18	20	69	(4)	(2)	22	(25)	58	84

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	4,070	4,190	4,315	4,600	4,629	4,789	5,101	5,434	5,889	6,328
<b>Cash &amp; Equivalents</b>	211	158	267	290	264	220	291	314	294	348
<b>Accounts Receivable</b>	289	345	366	390	437	472	530	776	684	638
<b>Goodwill &amp; Int. Ass.</b>	97	90	84	78	74	68	64	58	53	54
<b>Total Liabilities</b>	2,213	2,347	2,493	2,725	2,808	3,036	3,340	3,816	4,090	4,296
<b>Accounts Payable</b>	95	96	128	131	123	112	108	115	143	194
<b>Long-Term Debt</b>	140	140	190	290	290	320	371	372	372	373
<b>Shareholder's Equity</b>	1,857	1,842	1,822	1,875	1,821	1,752	1,761	1,618	1,800	2,033
<b>D/E Ratio</b>	0.08	0.08	0.10	0.15	0.16	0.18	0.21	0.23	0.21	0.18

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	4.6%	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%	5.7%	6.1%
<b>Return on Equity</b>	10.5%	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%	18.7%	19.6%
<b>ROIC</b>	9.4%	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%	15.4%	16.4%
<b>Shares Out.</b>	54.9	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3	55.4
<b>Revenue/Share</b>	50.64	50.68	51.33	54.74	54.51	58.36	61.74	61.08	71.76	68.36
<b>FCF/Share</b>	2.56	2.42	3.48	4.01	3.08	4.97	5.82	6.42	8.66	10.22

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

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