



# Mercury General (MCY)

Updated November 21<sup>st</sup>, 2022 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$36	<b>5 Year CAGR Estimate:</b>	7.5%	<b>Market Cap:</b>	\$2.0B
<b>Fair Value Price:</b>	\$42	<b>5 Year Growth Estimate:</b>	1.5%	<b>Ex-Dividend Date:</b>	12/14/22
<b>% Fair Value:</b>	86%	<b>5 Year Valuation Multiple Estimate:</b>	3.1%	<b>Dividend Payment Date:</b>	12/29/22
<b>Dividend Yield:</b>	3.5%	<b>5 Year Price Target</b>	\$45	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	D	<b>Rating:</b>	Hold

## 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 third quarter earnings results on November 1. The company reported net premiums earned of \$990 million for the quarter, which was up 6% compared to the previous year's period. Net premiums written rose by 2% year over year, to \$1.03 billion. The fact that net written premiums were up year over year will likely mean that earned premiums should see some growth during the coming quarters as well. Mercury General's investment income and investment gains were deeply negative for the quarter, at -\$100 million, which was the result of the equity market struggle and rising bond yields, which led to declining bond prices that caused fair value asset write-downs.

Mercury General's adjusted earnings-per-share totaled \$0.28 during the third quarter, which was considerably weaker than results during the previous year's quarter. Mercury General cut its dividend by 50% in 2022, ending its 33-year dividend growth history. Profits are forecasted to be negative this year due to realized and unrealized investment losses, which is why we calculate fair value with an earnings power estimate of \$3.00 for the current year as this seems like an appropriate estimate for the company's underlying earnings generation ability.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$2.13	\$2.18	\$2.28	\$2.34	\$1.73	\$1.64	\$1.80	\$2.60	\$5.54	\$5.03	<b>\$3.00</b>	<b>\$3.23</b>
<b>DPS</b>	\$2.44	\$2.45	\$2.46	\$2.47	\$2.48	\$2.49	\$2.50	\$2.51	\$2.52	\$2.53	<b>\$1.27</b>	<b>\$1.27</b>
<b>Shares<sup>1</sup></b>	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3	55.4	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 held true for 2021, 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 Million

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## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	19.6	20.1	21.5	23.1	30.8	35.0	28.9	18.8	9.2	10.5	<b>12.0</b>	<b>14.0</b>
Avg. Yld.	5.8%	5.6%	5.0%	4.6%	4.7%	4.4%	5.1%	5.1%	5.0%	4.8%	<b>3.5%</b>	<b>2.8%</b>

Mercury General's shares traded at quite high valuations for many 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 our earnings power forecasts for 2022, Mercury's shares trade below our fair value estimate right now.

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

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	115%	112%	108%	106%	143%	152%	139%	96.5%	45.5%	50.3%	<b>42.3%</b>	<b>39.3%</b>

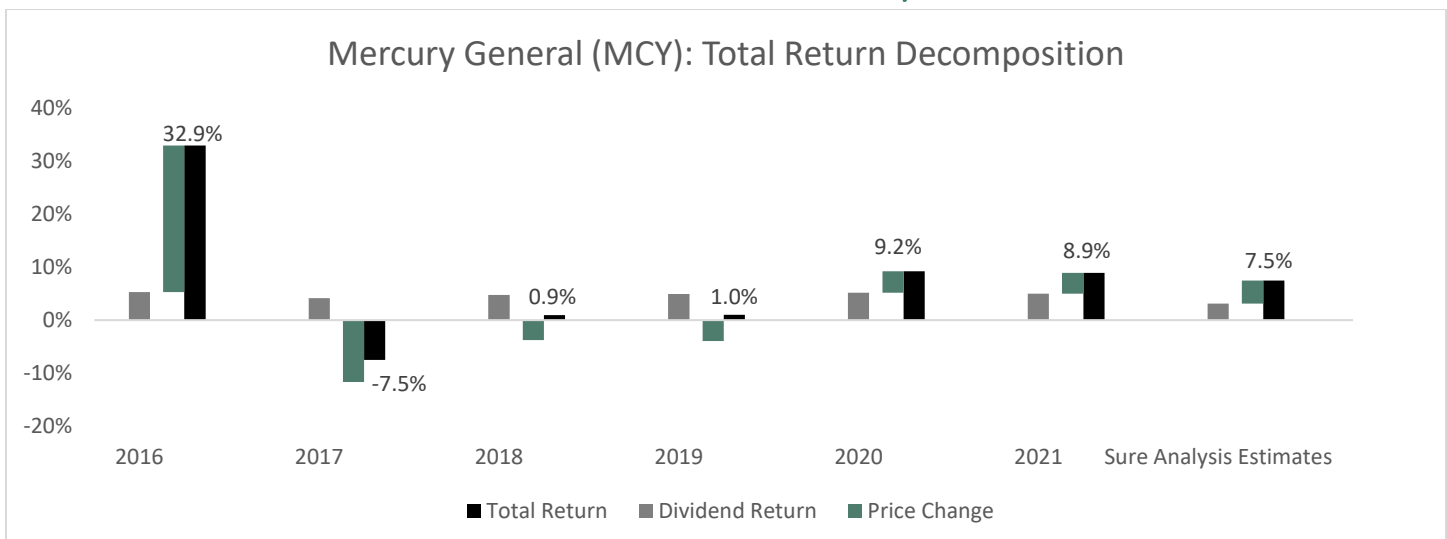
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in most of those years. But since the company is generating losses in 2022, it was forced to end its dividend growth streak – the company cut its dividend by half in summer 2022.

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

Mercury General was relatively resilient during the last financial crisis, and the company also performed well during the pandemic. Mercury General's earnings growth has been very inconsistent, however, and we do not see a lot of earnings-per-share growth in the long run. The company's dividend growth record has now been destroyed, but the longer-term total return outlook is not bad from the current level. We thus rate Mercury a hold right here.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	2,783	2,821	3,012	3,009	3,228	3,416	3,380	3,973	3,785	3,993
<b>D&amp;A Exp.</b>	37	31	28	48	53	55	59	65	68	79
<b>Net Profit</b>	117	112	178	74	73	145	(6)	320	375	248
<b>Net Margin</b>	4.2%	4.0%	5.9%	2.5%	2.3%	4.2%	-0.2%	8.1%	9.9%	6.2%
<b>Free Cash Flow</b>	133	191	220	170	275	322	355	480	566	460
<b>Income Tax</b>	18	20	69	(4)	(2)	22	(25)	58	84	51

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	4,190	4,315	4,600	4,629	4,789	5,101	5,434	5,889	6,328	6,772
<b>Cash &amp; Equivalents</b>	158	267	290	264	220	291	314	294	348	336
<b>Accounts Receivable</b>	345	366	390	437	472	530	776	684	638	661
<b>Goodwill &amp; Int. Ass.</b>	90	84	78	74	68	64	58	53	54	53
<b>Total Liabilities</b>	2,347	2,493	2,725	2,808	3,036	3,340	3,816	4,090	4,296	4,632
<b>Accounts Payable</b>	96	128	131	123	112	108	115	143	194	169
<b>Long-Term Debt</b>	140	190	290	290	320	371	372	372	373	373
<b>Shareholder's Equity</b>	1,842	1,822	1,875	1,821	1,752	1,761	1,618	1,800	2,033	2,140
<b>LTD/E Ratio</b>	0.08	0.10	0.15	0.16	0.18	0.21	0.23	0.21	0.18	0.17

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	2.8%	2.6%	4.0%	1.6%	1.6%	2.9%	-0.1%	5.7%	6.1%	3.8%
<b>Return on Equity</b>	6.3%	6.1%	9.6%	4.0%	4.1%	8.2%	-0.3%	18.7%	19.6%	11.9%
<b>ROIC</b>	5.9%	5.6%	8.5%	3.5%	3.5%	6.9%	-0.3%	15.4%	16.4%	10.1%
<b>Shares Out.</b>	54.9	55.0	55.1	55.2	55.3	55.3	55.3	55.3	55.4	55.4
<b>Revenue/Share</b>	50.68	51.33	54.74	54.51	58.36	61.74	61.08	71.76	68.36	72.12
<b>FCF/Share</b>	2.42	3.48	4.01	3.08	4.97	5.82	6.42	8.66	10.22	8.31

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

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