



Mercury General (MCY)

Updated February 13th, 2024 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|----------------------------------|----------|
| Current Price: | \$40 | 5 Year CAGR Estimate: | 4.8% | Market Cap: | \$2.2B |
| Fair Value Price: | \$42 | 5 Year Growth Estimate: | 1.0% | Ex-Dividend Date: | 03/12/24 |
| % Fair Value: | 95% | 5 Year Valuation Multiple Estimate: | 1.0% | Dividend Payment Date: | 03/27/24 |
| Dividend Yield: | 3.2% | 5 Year Price Target | \$44 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | D | Retirement Suitability Score: | F | Rating: | 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 fourth quarter earnings results on February 13. The company reported net premiums earned of \$1.14 billion for the quarter, which was up 14% compared to the previous year's period. Net premiums written rose by 24% year over year, to \$1.13 billion. The fact that net written premiums were up substantially year over year means that earned premiums should rise during the coming quarters as well. Mercury General's net realized investment income/losses were positive for the quarter, at \$128 million, which was way better compared to the previous year's quarter during which Mercury General generated investment gains of \$74 million.

Mercury General's adjusted earnings-per-share totaled \$1.15 during the fourth quarter, which was considerably better than results during the previous year's quarter. This was caused by below-average catastrophe losses during the period, which helped the company's margins. The company is expected to generate a rather small profit in 2024, 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 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|---------|--------|---------------|---------------|
| EPS | \$2.28 | \$2.34 | \$1.73 | \$1.64 | \$1.80 | \$2.60 | \$5.54 | \$5.03 | -\$2.30 | \$0.30 | \$3.00 | \$3.15 |
| DPS | \$2.46 | \$2.47 | \$2.48 | \$2.49 | \$2.50 | \$2.51 | \$2.52 | \$2.53 | \$1.27 | \$1.27 | \$1.27 | \$1.27 |
| Shares¹ | 55.1 | 55.2 | 55.3 | 55.3 | 55.3 | 55.3 | 55.4 | 55.4 | 55.4 | 55.4 | 55.5 | 56.0 |

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.

¹ In Million

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Valuation Analysis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now | 2029 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 21.5 | 23.1 | 30.8 | 35.0 | 28.9 | 18.8 | 9.2 | 10.5 | NMF | 123 | 13.3 | 14.0 |
| Avg. Yld. | 5.0% | 4.6% | 4.7% | 4.4% | 5.1% | 5.1% | 5.0% | 4.8% | 3.8% | 3.4% | 3.2% | 2.9% |

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 2024, Mercury's shares trade slightly below our fair value estimate right now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|-------|-------|-------|------|------|-------|-------|
| Payout | 108% | 106% | 143% | 152% | 139% | 96.5% | 45.5% | 50.3% | NMF | NMF | 42.3% | 40.3% |

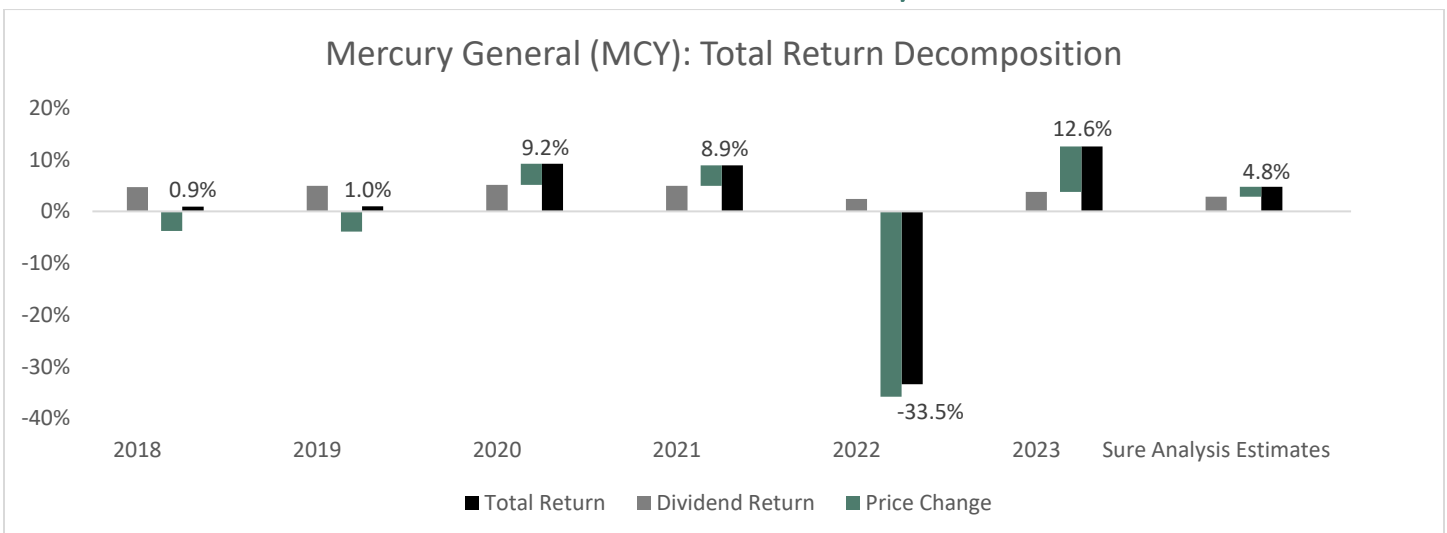
Mercury General has paid out more than 100% of its reported net earnings throughout some of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in most of those years. But since the company generated losses 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 reasonably 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 been destroyed, but the longer-term total return outlook is still not bad. We thus rate Mercury a hold right here.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Revenue | 2,821 | 3,012 | 3,009 | 3,228 | 3,416 | 3,380 | 3,973 | 3,785 | 3,993 | 3,643 |
| D&A Exp. | 31 | 28 | 48 | 53 | 55 | 59 | 65 | 68 | 79 | 82 |
| Net Profit | 112 | 178 | 74 | 73 | 145 | (6) | 320 | 375 | 248 | (513) |
| Net Margin | 4.0% | 5.9% | 2.5% | 2.3% | 4.2% | -0.2% | 8.1% | 9.9% | 6.2% | -14.1% |
| Free Cash Flow | 191 | 220 | 170 | 275 | 322 | 355 | 480 | 566 | 460 | 317 |
| Income Tax | 20 | 69 | (4) | (2) | 22 | (25) | 58 | 84 | 51 | (158) |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 4,315 | 4,600 | 4,629 | 4,789 | 5,101 | 5,434 | 5,889 | 6,328 | 6,772 | 6,514 |
| Cash & Equivalents | 267 | 290 | 264 | 220 | 291 | 314 | 294 | 348 | 336 | 290 |
| Accounts Receivable | 366 | 390 | 437 | 472 | 530 | 776 | 684 | 638 | 661 | 592 |
| Goodwill & Int. Ass. | 84 | 78 | 74 | 68 | 64 | 58 | 53 | 54 | 53 | 52 |
| Total Liabilities | 2,493 | 2,725 | 2,808 | 3,036 | 3,340 | 3,816 | 4,090 | 4,296 | 4,632 | 4,992 |
| Accounts Payable | 128 | 131 | 123 | 112 | 108 | 115 | 143 | 194 | 169 | 152 |
| Long-Term Debt | 190 | 290 | 290 | 320 | 371 | 372 | 372 | 373 | 373 | 398 |
| Shareholder's Equity | 1,822 | 1,875 | 1,821 | 1,752 | 1,761 | 1,618 | 1,800 | 2,033 | 2,140 | 1,522 |
| LTD/E Ratio | 0.10 | 0.15 | 0.16 | 0.18 | 0.21 | 0.23 | 0.21 | 0.18 | 0.17 | 0.26 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Return on Assets | 2.6% | 4.0% | 1.6% | 1.6% | 2.9% | -0.1% | 5.7% | 6.1% | 3.8% | -7.7% |
| Return on Equity | 6.1% | 9.6% | 4.0% | 4.1% | 8.2% | -0.3% | 18.7% | 19.6% | 11.9% | -28.0% |
| ROIC | 5.6% | 8.5% | 3.5% | 3.5% | 6.9% | -0.3% | 15.4% | 16.4% | 10.1% | -23.1% |
| Shares Out. | 55.0 | 55.1 | 55.2 | 55.3 | 55.3 | 55.3 | 55.3 | 55.4 | 55.4 | 55.4 |
| Revenue/Share | 51.33 | 54.74 | 54.51 | 58.36 | 61.74 | 61.08 | 71.76 | 68.36 | 72.12 | 65.79 |
| FCF/Share | 3.48 | 4.01 | 3.08 | 4.97 | 5.82 | 6.42 | 8.66 | 10.22 | 8.31 | 5.73 |

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

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