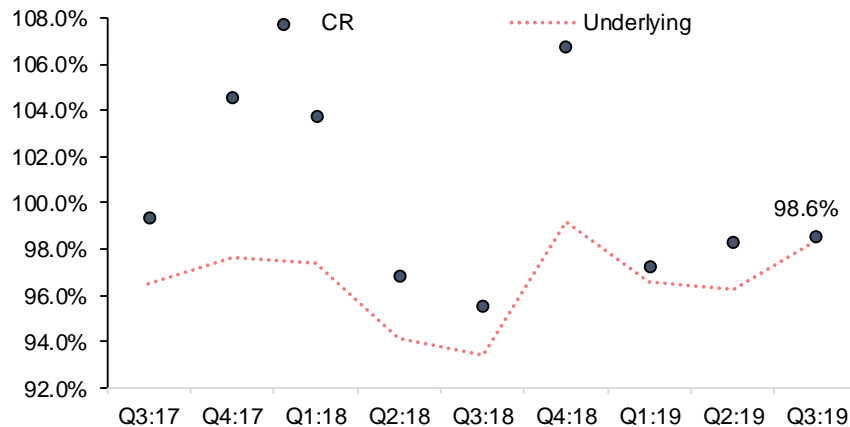


October 28, 2019

MERCURY: 4% SEQUENTIAL RISE IN FREQUENCY & SEVERITY

On Monday morning, Mercury General reported disappointing earnings for the quarter, including a 30% decline in its operating EPS to \$0.78 per share. The result missed analyst estimates of \$1.15 per share. The shares closed down 11%.

The results stem from a higher combined ratio, and more specifically from the personal auto LoB outside of California, and the firm's commercial auto business. Together, the segments added 2.8pts to the companywide combined. The firm's Ex-CA private auto combined of 101% was up 19pts YoY, and the CA commercial auto combined of 120% was up 30pts YoY. The ex-California private auto combined was 97.6%, up 0.2pts YoY.

Management also highlighted frequency and severity trends, which were both up 4% sequentially, but that recent rate hikes only partially offset the broader market trends.

Comments were also made on recent California wildfires having caused damage, but it being too early to estimate losses.

Forward guidance in the firm's earnings call included a higher exact Q4:19 combined in comparison to the rest of the year given the increase in loss frequency and severity resulting from seasonal driving weather.

As we have [previously written](#), with signs of severity pressures so far offset by benign frequency, any change in frequency trends is a potential wildcard that could change the dynamic in the personal auto market where [price competition has stepped up](#).

Mercury's results should not be over-interpreted due to its geographic concentration in California (87%) and the fact that one quarter does not make a trend. However, it represents a significant data point that is worth continuing to watch given macro-economic factors that should be supportive of more miles driven, especially considering CA is the auto market's largest state, representing some 12% of industry total private auto premiums.

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Mercury General, Key Statistics

Market Cap (\$mn)	2,945
Share price	47.3
MTD	(15.3)%
YTD	(8.5)%
1-YR	(6.6)%
3-YR	(6.2)%
Div Yield	4.7%
Price / Earnings	15.1 x
Price / Book	1.7 x
Price / Tangible Book	1.7 x

Source: S&P Global, Inside P&C

MERCURY: 30% DECLINE IN EPS, 11% FALL IN SHARE PRICE

❖ **Operating EPS decline of -30% to \$0.78**

On Monday, Mercury General released its third quarter results, including a 5pt deterioration in its underlying loss ratio to 74.2%, and -5% growth in its net investment income to \$36.4mn. Operating EPS of \$0.78 per share was down 30% YoY missing estimates of \$1.15. The shares closed down 11%.

Catastrophe losses of 0.3pts (\$3mn) was down 1.2pts (\$10mn) YoY, and largely stemmed from hurricanes in Texas.

On growth, net written premiums were up 8.6%, with total sequential PIF growth of -0.2%, down from 0.8% in Q2:19, and 1.3% in Q1:19.

The 4.7% decline in net investment income stemmed from a lower average yield on investments, offset by a higher average invested assets.

EXHIBIT: MERCURY GENERAL Q3:19 EARNINGS RESULTS

Source: Company Reports, Inside P&C

(\$k)	Mercury General (MCY)					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
Operating EPS	\$ 1.11	\$ (0.26)	\$ 0.87	\$ 0.74	\$ 0.78	(30.4%)
NWP	905,339	850,609	916,448	936,079	983,056	8.6%
NII	38,159	31,383	34,174	35,032	36,356	(4.7%)
Loss and LAE	614,069	724,939	630,416	656,577	680,928	10.9%
Operating expenses	206,199	201,870	215,902	217,049	221,270	7.3%
Op. income	61,667	(14,599)	48,119	41,120	42,956	(30.3%)
Cats	1.5%	5.0%	0.6%	1.0%	0.3%	(1.2)pts
PPD	0.7%	2.6%	0.1%	1.0%	-0.1%	(0.8)pts
AY ex-cat loss ratio	69.3%	75.9%	71.8%	71.8%	74.2%	4.9pts
Loss ratio	71.6%	83.5%	72.4%	73.9%	74.4%	2.9pts
Expense ratio	24.0%	23.3%	24.8%	24.4%	24.2%	0.2pts
Combined ratio	95.6%	106.7%	97.3%	98.3%	98.6%	3.0pts

Highlights for Q3:19 included:

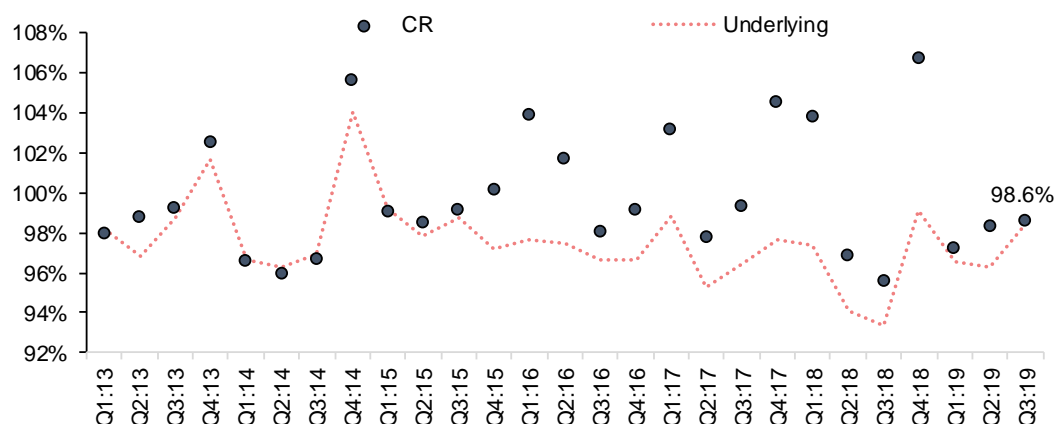
- **Operating EPS:** -30% growth to \$0.78.
- **Net investment income:** -5% growth to \$36mn.
- **Operating income:** down 30% to \$43mn.
- **Combined ratio:** up 3pts to 98.6%.
- **Reserve development:** Favorable development of 0.1pts.
- **Frequency:** flat YoY
- **Severity:** +7% YoY
- **CA personal auto rate:** 6.9%
- **NWP growth:** 8.6%

Underwriting results push down operating EPS

On underwriting, the firm's combined ratio deteriorated 3pts to 98.6%. During the company's earnings call **CEO Gabriel Tirador** stated how deterioration stemmed from the personal auto LoB outside of California, and the firm's commercial auto business. Combined, they added 2.8pts to the companywide combined ratio. During the firm's call, Tirador highlighted that the 4% sequential increase it saw in frequency and severity were only partially offset by recent rate increases. The firm's underlying combined of 98.4% is above it's Q3:18 results of 93.4% and its Q3:17 result of 96.5%.

EXHIBIT: MERCURY GENERAL COMBINED RATIO

Source: Company Reports, Inside P&C



Underwriting results highlights:

- Ex-California private auto combined: 101%, up 19pts YoY
- California private auto combined: 97.6%, up 0.2pts YoY
- California commercial auto combined: 120%, up 30pts YoY
- Homeowners combined 97.5%, down 3.7pts YoY

Loss trends:

- Frequency: flat YoY, +4% sequentially
- Severity: +7% YoY, +4% sequentially.

Rate filings:

- California personal auto: +6.9% in California Auto Insurance company, March 2019, and +6.9% Mercury Insurance company, May 2019.
- ~81% California Auto Insurance Company rate earned during the quarter
- California homeowners, +6.9% in August 2019. Recently filed another 6.9% rate increase.

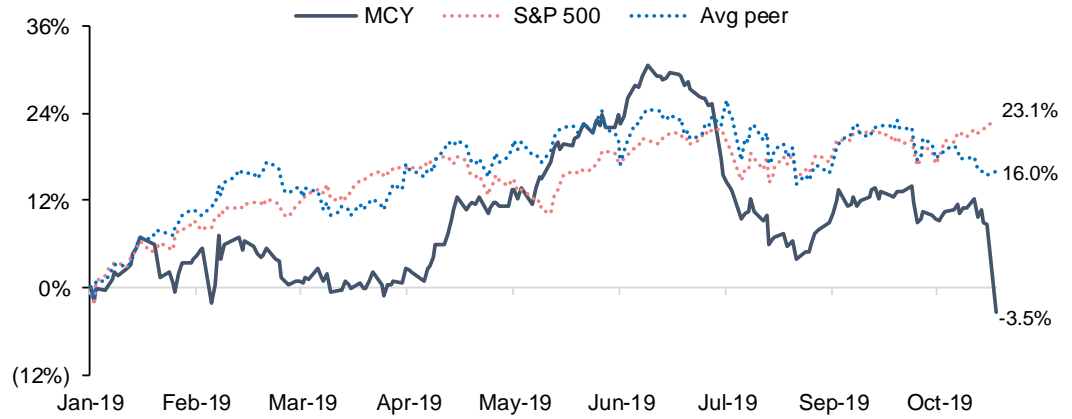
Stock reacts negatively, closing down 11%

Investors were not impressed with the quarterly result, with shares dropping 11% following the release, and closing at \$47.31 per share. This compared to the

market which was up ~50bps. Year to date, Mercury is down 3.5%, trailing both the S&P 500 and its average peers.

EXHIBIT: PERSONAL AUTO PEER GROUP YTD TOTAL RETURN

Source: S&P Global, Inside P&C



This research report was written by Insider Publishing's Research team which includes Gavin Davis, James Thaler, Gianluca Casapietra, and Dan Lukpanov.

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