Report Date: 2/12/25
Company: Mercury General Corporation
Ticker: MCY (NYSE)
Industry: Insurance
Stock Price (USD): $58.21
Market Cap (USD, Millions): $3,267

WOLFPACK RESEARCH

We Believe MCY's Loss Estimate Is Highly Misleading and Management is Playing a Dangerous Game of Pretend and Extend

In our view, MCY's earnings PR is highly misleading and raises more questions than it answers. We think MCY is hiding risk as MCY is an outlier from each of their four peers that have reported in the last two weeks in almost every key aspect:

- MCY is reporting far lower losses per average PIF than their peers. Less than 50% in many cases.
- MCY is the only carrier to exclude FAIR assessments from their gross losses, even though the first assessment was made yesterday.
- MCY is the only carrier including subrogation benefits in their net loss numbers, even though it will take years for these benefits to develop, if ever.
    - This subrogation benefit is key to the net loss figures MCY provides, without it, none of the numbers provided add up!
- MCY is the only carrier that has not figured out whether it will treat this as 1 or 2 events.
- Unlike its peers, MCY has not disclosed the number of claims filed, and admits that it is using historical estimates, instead of the granular data they have, to estimate losses.

We think they are understating their losses to the market in hopes that they can bring in premiums and slow walk revisions in its losses over the next 2-3 quarters and keep their heads above water. The range of net losses provided by MCY is highly misleading and, frankly, absurd. The only way to get to the numbers they provide is by excluding lots of costs and losses that they know exist, and by giving themselves credit for benefits that are purely speculative.

- MCY's loss estimates based on "historical estimates" are far lower than peers when you compare their damages to the number of policies-in-force (PIF), an assessment that anyone can make using rate filings. For example, Allstate and Travelers each have ~50% of the PIFs exposed to Altadena (91001) and Pacific Palisades (90272) as MCY, yet they have the same, or even higher estimates of loss! Farmers, which also has fewer PIFs, had

1/3 as many policies in the much more expensive Pacific Palisades as MCY and so was almost completely concentrated into Altadena, where losses per dwelling are lower, yet MCY still estimates a lower Average Loss Per PIF!

**$'s In Millions*

Carrier	HO-3 PIF (91001)	HO-3 PIF (90272)	Reported Gross Losses	Average Loss Per PIF
Allstate	403	233	$ 2,000,000	$ 3,145
Travelers	263	372	$ 1,700,000	$ 2,677
Farmers	1,161	137	$ 1,875,000	$ 1,445
Mercury	929	385	$ 1,800,000	$ 1,370

Source: Carrier Rate Filings, Reported Carrier Loss Estimates, Wolfpack Analysis

- So, we can see MCY is grossly out of step with other carriers, and we think they did this by using *historical* estimates. *"These estimates are based on information known to date informed by historical claims settlement information from previous major wildfires to calculate estimated gross ultimate losses."* The problem is that these fires are not the same as other fires. The Commissioner is pushing all carriers to pay 100% of the limit for content with no questions asked. Inflation and scarcity of labor will drive up construction costs. Besides, MCY has already paid out $800 million, which (according to their rosy estimates) is 40-50% of the total amount of gross losses to be paid. Shouldn't they be able to estimate their losses based on their actual losses at this point, as other peers have?
- MCY's average loss per HO-3 PIF is 57% of peers, with the peer average at $2.4 million.[1] That's the benefit of working with historical estimates! We estimate MCY's worst-case scenario loss estimate for the Eaton fire implies losses of no more than $882k per PIF (HO-3+Landlord). This does not pass the smell test for us, recent media reports concerning a MCY policyholder from the Eaton Fire state they were entitled up to $1.7 million of coverage from the destruction of their home.[2] We stand by our initial estimate that $2 billion is the floor for their losses, and given what their peers are reporting, we think that losses will end up being closer, if not above, $2.5 billion.
- Perhaps the most disingenuous thing MCY has done is factor its supposed subrogation benefits into its outlook for net losses. Essentially, MCY believes that the utility is

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[1] Peers include Allstate, Travelers, and Farmers

[2] This policyholder only paid $1,264 v. MCY's average premium paid is ~$1,800 in Altadena

responsible for the Eaton fire, and they are already factoring in their cut of a lawsuit that will take years to resolve into its results. Is anyone else doing this? NO! For example, if Farmers included subrogation benefits, they basically wouldn't have had any liability because their losses are almost entirely concentrated in Altadena.

- Subrogation is anything but a sure thing. The utility has said "Electrical data from the four energized transmission lines that run through Eaton Canyon showed no anomalies until one hour after the reported start time of the fire." Factoring in subrogation at this point is grossly misleading. The only justification for adding in subrogation to reduce your net losses at this point is that they had a number in mind they wanted to get to, and this was how they were going to get there.
- Also, if you read the PR closely you will see that MCY's gross estimate is not really an estimate of gross losses because it excludes FAIR assessments. The other carriers, like Allstate, Chubb, and Travelers have included their expected FAIR assessments in their gross loss numbers. MCY's excuse for not including a FAIR assessment in its gross estimate? It's paid by reinsurance, and going forward they can recoup from policy holders, so it's not a big deal (on net). Why didn't other carriers exclude FAIR assessments? Maybe they thought their gross loss estimate should include all their gross losses!

  *Between the **coverage afforded by reinsurance** and the **ability to recoup** a portion of the assessment, the Company does not expect the FAIR plan assessment to materially add to the **net** wildfire losses from these events.*
- FAIR assessments are not a myth, it appears they will come in tranches as losses in excess of surplus and reinsurance for the FAIR program are piling up. Just yesterday the first $1 billion was assessed, adding ~$60 million to MCY's gross losses. More are expected! But not apparently by MCY who either couldn't or wouldn't do the math.
- Apparently MCY is so confused about its losses that unlike all of its peers it still hasn't figured out if they want one or two reinsurance towers. Does anyone really believe they are still this clueless? Even in their most optimistic scenario they are going to blow the top off the first tower. We have talked with numerous people in the industry at this point and there is a wide variety of opinions on whether this will result in litigation, but they all agree that the specific language of the contract is what will matter. And MCY has not and

likely will not produce the contract for investors to review, and we haven't heard from the reinsurer, so we are going to take MCY's claims they get to choose one or two towers with some salt. If they are stuck with one event, then they are proper fucked.

- MCY has also not said anything about the status of the California subsidiary that holds all of these policies. MCY has paid out $800 million so far and has only been reimbursed for $500 by the reinsurer, it seems like subsidiary is in the hole for $300 million. The total surplus for the CA subsidiary was just $388 as of Q3 24, making this entity nearly insolvent. The WSJ wrote an extensive article on State Farm's issues with its insolvent subsidiary in CA. Is MCY going to isolate its subsidiary or will its losses spread like contagion and eat up capital at its other subsidiaries? Are they talking to the CA regulator about this? Investors should know.
- MCY discloses that they can only have a 3-1 premium to capital ratio in their SEC filings. The loss of capital caused by this event, to say nothing of the cash flow crunch created by the need to pay out claims, will seriously inhibit their ability to write new policies and take advantage of any rate cycle increase.
- The range of net losses provided by MCY is highly misleading and, frankly, absurd. The only way to get to the numbers they provide is by excluding lots of costs and losses that they know exist, and by giving themselves credit for benefits that are purely speculative. They appear to exclude any FAIR loss estimate from the gross calculation. They also seem to exclude reinstatement fees from the net losses, even though they will probably need to pay $200 million or go naked. They exclude the $30 million reimbursement they owe to insurers for depleting their first tower if the reinsurers loss ratio exceeds 73.5%. And they appear to have excluded the $52 million co-participation obligation in the second reinsurance tower.
- The only way that we figure they could get to the bottom of their range of $155 million is to assume that MCY will only be responsible for the $150 million retention on its first tower and a portion of the $6.5 million in reinsurance that it is not eligible to collect from the first tower. What about the $150 million retention for the second tower? Reinsurance restatement fees of $100-200 million? Co-participation in the second tower of $52 million? Apparently, that will all be covered by subrogation from litigation that is in its infancy. MCY will have to pay these fees as well as claims to their insured that they

apparently refuse to account for today in their net losses. This will create a huge cash flow issue that management apparently would like investors to ignore.

- Our assessment of MCY's losses is that they will hit $2.5 billion. This is in line with what their peers have reported and includes a FAIR assessment estimate. We also ignored the potential beneficial effects of subrogation, and factored in the reinstatement fees they will need to pay, and needless to say our pretax net loss number was much higher. We calculate net losses in a one event scenario would be $1.3 billion. In a two-event scenario, losses come in at a much more modest $491 million. That is what we think is the lower bound for ultimate potential losses for MCY.

	$2.5bn Gross Loss	
	One Event	**Two Events**
Reinsurance Limit	$ 1,290	$ 2,528
MCY Retention	$ 150	$ 300
Reinsurance Covers	$ 1,290	$ 2,269
MCY Losses After Reinsurance	$ 1,129	$ -
Remaining Reinsurance	$ -	$ 259
Reinstatment #1	$ 101	$ 101
Reinstatement #2	$ -	$ 100
MCY Reimbursement	$ 30	$ 30
MCY Co-Participation	$ -	$ 52
Pre-Tax CAT Losses	***$ 1,410***	***$ 583***
Net Investment Income	$ 75	$ 75
Net Realized Investment Gain (Loss)	$ 25	$ 25
Interest Expense	$ 8	$ 8
MCY Pre-Tax Net Loss	$ 1,318	$ 491

Source: MCY Filings, Wolfpack Analysis

We are going to be on the earnings call today, and we hope that management will be professional enough to take our questions:

- How do you justify the fact that your loss per property is far below the other carriers, even Farmers who proportionately had far more exposure than you to the less expensive neighborhoods damaged by the Eaton fire?
- How can you justify basing your losses on historical estimates when you have the addresses of the homes in these zip codes, pictures of their structural status, and access to the claims filed by the homeowners? How many claims have been filed and how many insured homes are a total loss?
- How can you justify not including a FAIR assessment in your gross losses when all the other carriers included it? Do you understand what gross losses are?
- How do you justify including subrogation as a factor in your net losses when other carriers have not done the same? Has a lawsuit even been filed yet?
- Have you talked to your reinsurer about using 2 towers? Do they see the contract the same way as you, or is there a chance this will need to be settled in court?
- How is your California subsidiary? Is it solvent? Will you need to redeploy capital from other parts of the business to pay its claims?
- Are you including reinsurance reinstatement fees in your net losses? Why not? Are you factoring in subrogation gains? How much? Can you run us through the math of how you get from $2 billion in gross losses (excluding a FAIR assessment) down to $325 million?

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