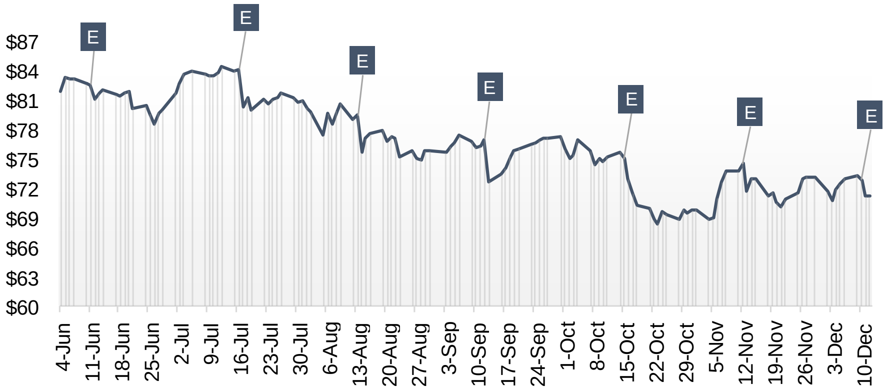
Inside P&C

by The Insurance Insider

December 12, 2019

THE OVERSHOOT RISK, REVISITED

Progressive stock price chart with earnings dates



Progressive's national footprint and best in class real-time data and analytics make it a reasonable proxy for the auto insurance market and a likely leading indicator for market-wide trends.

In 2014 the firm was the first to start increasing pricing in response to rising frequency and severity trends that initially slowed its growth but later proved prescient as competitor after competitor revealed they had grown too aggressively and had gotten behind the curve on pricing. And the firm was later among the first to see growth returning and then the improving environment emerging from 2017 on driven by lower frequency.

However, Progressive's recent results suggest the auto insurance market in 2020 is likely to be very different from the recent environment. Companies entered 2019 at peak margins, and have pivoted en masse to growth at the same time. This has resulted in a precipitous decline in the pricing environment, from 9% as recently as early 2018 to a second consecutive month of negative pricing reported today by the CPI, marking the lowest level since 2007. Growth has also become more expensive to achieve, as advertising, lead gen and online traffic costs respond to demand-surge.

With mild frequency only partially offsetting continued normal-ish increases in severity, a steady decline in margins from peak to normal levels was an entirely expected outcome, and something we have been talking about since early August.

That seems to have played out as expected. This month, Progressive reported a Personal Combined ratio of 94.5%, with Agency at 92.3% and Direct running hot above its "never exceed" 96% annual target. The result included a 1.9pt increase in the personal auto loss ratio YoY.

Of course, monthly results are noisy, and part of the deterioration was driven by actuarial adjustments on the current calendar year. Nevertheless, it is worth noting two things. The first is that the direction of travel on margins has been clear for several months. And second, the direction of these actuarial adjustments has been net negative in 2019 to date, signifying trends coming in consistently worse than expected. In fact, current year actuarial adjustments have added 0.3pts to the personal lines combined.

Of course, this is no cause for alarm. Trending back towards target margins only implies Progressive is making the necessary adjustments to pricing required to be as competitive as possible while still making target returns. And in many ways, 2020 is likely to represent more of a return to normalcy

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Progressive, Key Statistics

Market Cap ($mn)	**41,602**
Share price	**71.16**
MTD	**(2.6)%**
YTD	**18.0%**
1-YR	**12.1%**
3-YR	**107.6%**
Div Yield	**0.6%**
Price / Earnings	**13.3 x**
Price / Book	**3.1 x**
Price / Tangible Book	**3.2 x**

Source: S&P Global, Inside P&C

for personal lines companies, attempting to optimize the growth/profitability trade-off after a transitional 2019.

But with some of the overly enthusiastic sentiment still unwinding – signified by continued stock falls by Progressive on monthly earnings (-2.3% Wednesday) – all indications are risks are skewed to the downside relative to sentiment.

Our view is the cyclical nature of this business adds risk that companies might get a little too ahead of themselves on price competition and be vulnerable should the frequency environment become less accommodative (and there are real risk factors here). We have dubbed this the "Overshoot risk".

While there is no guarantee how trends will ultimately play out, our view is that these periods represent the moment of peak downside risk for these types of companies.

PROGRESSIVE: UNDERLYING LOSS RATIO UP 3 POINTS

Highlights for November included:

- **Operating EPS**: decreased 18% to $0.32.
- **Net investment income**: Up 5% to $85mn YoY, down 10.5% from October. Notably, the firm's book yield fell to 2.8% from 3.2% last month reflecting lower interest rates.
- **Underwriting income**: Fell 23.7% to $168mn.
- **Combined ratio**: Up 2.8pts to 94.1%, driven by 4.7pt deterioration in the underlying loss ratio to 73.2%, likely result of severity trends outpacing frequency tailwinds.
- **Reserve development**: Unfavorable development of 0.3% was lower than 0.7% in November last year.

EXHIBIT: PROGRESSIVE NOVEMBER RESULTS

Source: Company Reports, Inside P&C

($mn)	Progressive (PGR) monthly					
Period:	**Nov-18**	**Aug-19**	**Sep-19**	**Oct-19**	**Nov-19**	**VAR**
Operating EPS.	**$ 0.38**	**$ 0.34**	**$ 0.38**	**$ 0.39**	**$ 0.32**	**(18.0%)**
NWP	**2,328**	**2,921**	**3,024**	**3,656**	**2,596**	11.5%
NII	**81**	**90**	**84**	**95**	**85**	4.8%
U/W income	**220**	**184**	**216**	**210**	**168**	(23.7%)
Cats	**1.8%**	**0.2%**	**0.0%**	**0.0%**	**0.0%**	(1.8)pts
PPD	**0.7%**	**1.0%**	**(1.6%)**	**0.3%**	**0.3%**	(0.4)pts
AY ex-cat LR	**68.5%**	**71.7%**	**72.9%**	**73.3%**	**73.2%**	4.7pts
Loss ratio	**71.0%**	**72.9%**	**71.3%**	**73.6%**	**73.5%**	2.5pts
Expense ratio	**20.3%**	**20.5%**	**21.0%**	**20.4%**	**20.6%**	0.3pts
Combined ratio	**91.3%**	**93.4%**	**92.3%**	**94.0%**	**94.1%**	2.8pts

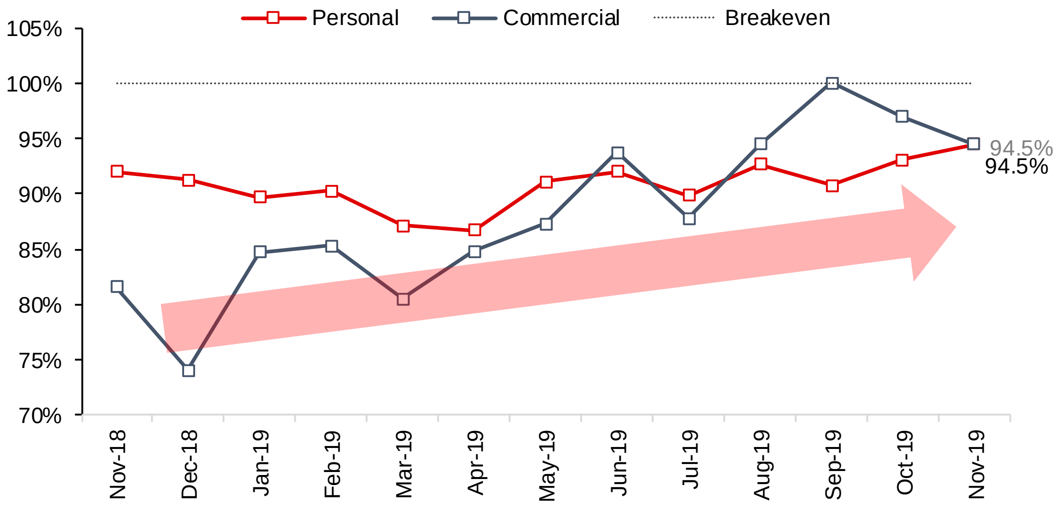
Underwriting results

All in, the headline combined of 94.1% is up 2.8pts from last year, driven by the loss ratio deterioration in all underwriting segments excluding property. In November, the firm recorded 0.3pts of unfavorable development and no catastrophe losses.

- Progressive's **accident year loss ratio** deteriorated 4.7pts to 73.2%. Excluding the effect from the reversal of a portion of the reinsurance recoverable under ASL agreements and amortization of expense associated with the acquisition of ARX, the accident year loss ratio increased 3.0pts to 71.9%.
- The **commercial segment** saw a 12.9pt increase in the combined to 94.5%, with 2pts contributed by the calendar year actuarial adjustments.
- In **personal lines**, the CR was 94.5%, up 2.5pts from last year.
- In **property**, the combined of 95.7% was down 8.5pts from last year, due to lower catastrophe losses.

EXHIBIT: PROGRESSIVE COMBINED RATIO BY SEGMENT

Source: Company Reports, Inside P&C



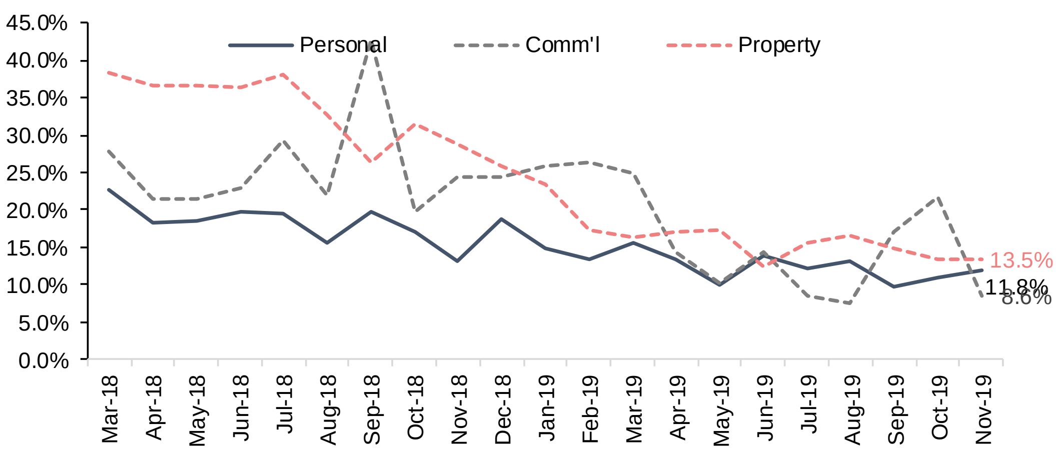
Growth

NWP grew across all segments. November's total NWP growth of 11.5% is down 3.6pts from last year, driven by declining growth in all segments. However, it is worth noting that November is one of the two seasonally lowest underwriting months for Progressive and hence may be one of the least useful for tracking growth trends.

The firm's core and by far largest personal segment grew 11.5%, down 6.6pts from last year. The commercial business grew 17.7%, down 10.5pts from last year.

EXHIBIT: PROGRESSIVE NWP GROWTH BY SEGMENT

Source: Company Reports, Inside P&C

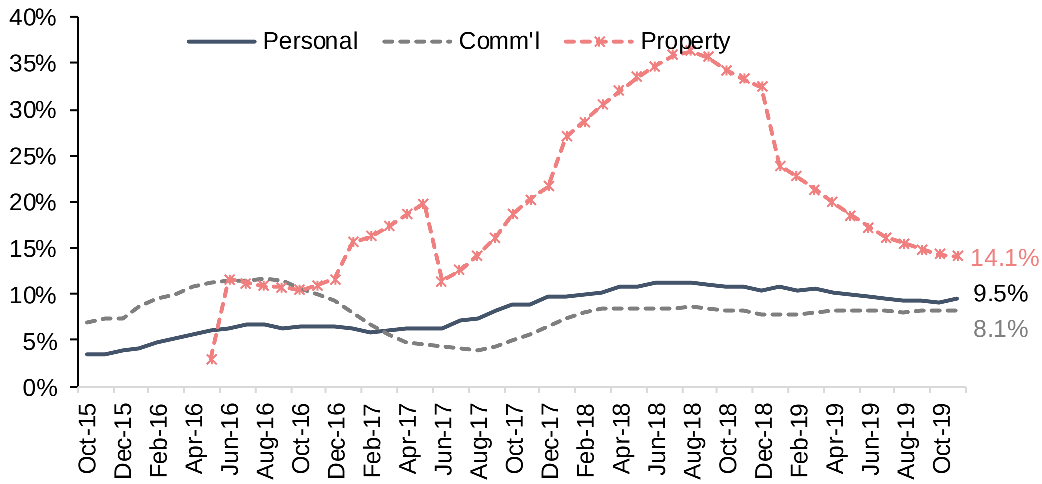


PIF growth continues, homeowners continues to slow

Personal PIF growth in November was 9.5%, down from 10.7% last year. Commercial PIF growth remained stable at 8.1%. Property at 14.1% is down 19pts YoY. Overall, total PIF growth is down 2.5pts at 9.9%.

EXHIBIT: PROGRESSIVE PIF GROWTH BY SEGMENT

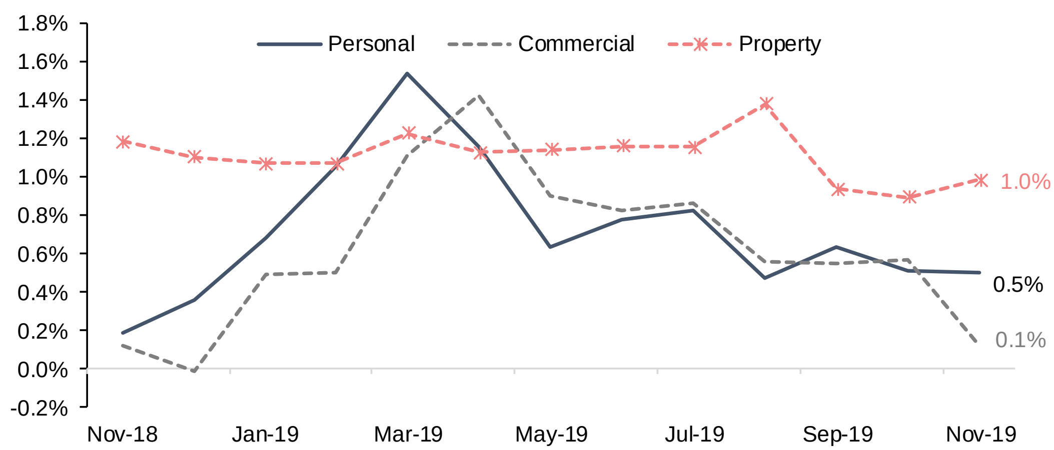
Source: Company Reports, Inside P&C



Sequentially, personal lines PIF grew 0.5% (flat versus October), commercial 0.1% (slowdown from 0.6%), and property at 1.0% (from 0.9%).

EXHIBIT: PROGRESSIVE SEQUENTIAL PIF GROWTH BY SEGMENT

Source: Company Reports, Inside P&C

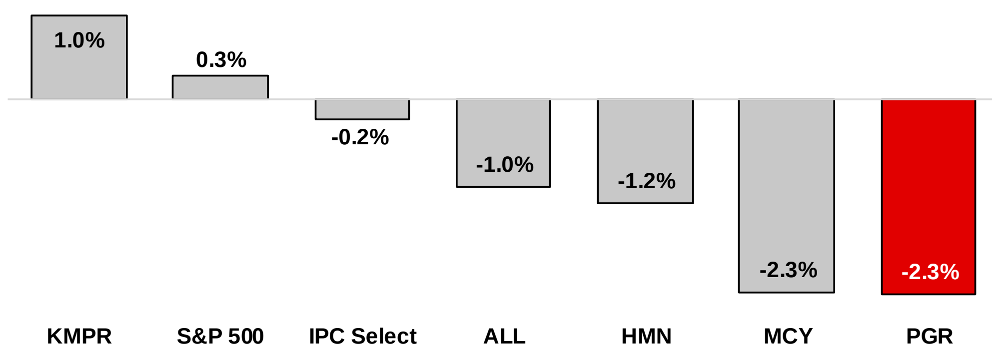


Results disappoint investors for seven back-to-back months

Progressive's November results send the stock down 2.3% on Wednesday, which resulted in the stock being the worst one-day performer in Inside P&C Select (the stocks of 36 largest US and Bermuda P&C carriers).

EXHIBIT: PERSONAL AUTO PEER GROUP AND MARKET BENCHMARK ONE-DAY PRICE CHANGE

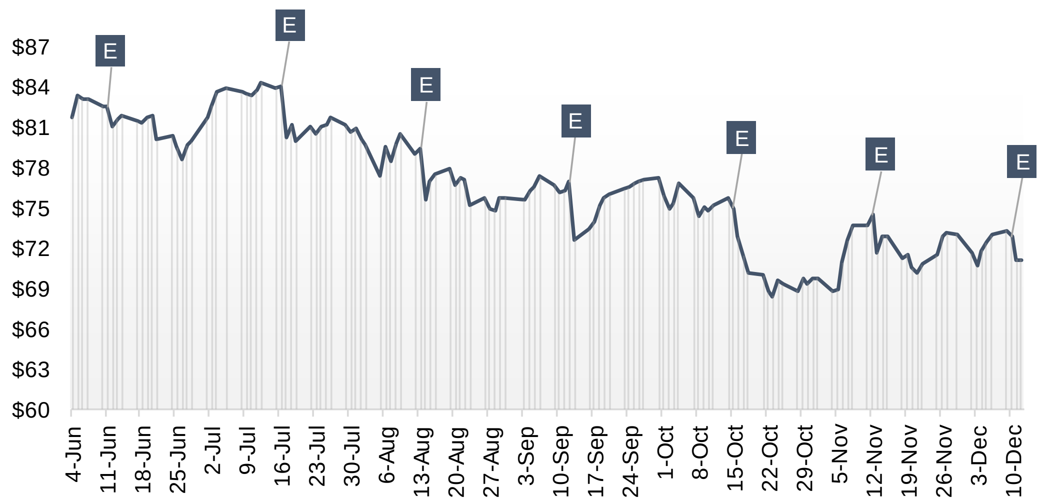
Source: Company Reports, Inside P&C



Notably, Progressive's results failed to meet investor expectations for the seven consecutive month.

EXHIBIT: PROGRESSIVE STOCK PRICE CHARTS WITH EARNINGS DATES

Source: Company Reports, Inside P&C



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